DTG

Dakota Telecommunications Group

EX PARTE OR LATE FILED

February 18, 1999

Tradition

Technology

Talent

Teamwork

**HEADQUARTERS**
P.O. Box 66
29705 453rd Avenue
Irene, South Dakota
57037-0066

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800.239.7501
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www.dtg.com

Federal Communications Commission
ATTN: Magalie Roman Salas
1919 M Street, N.W.
Room 222
Washington, D.C. 20554

RE: Ex Parte Comments – CS Docket No. 98-178

Attached are two copies of ex parte comments as required by Section 1.1206(b)(1) of the Commission's rules.

Sincerely,

William P. Heaston
General Counsel

Exhibits enclosed

No. of Copies rec'd 0+1
List ABCDE

TRANSFORMING COMMUNICATIONS

**Before the Federal Communications Commission**
**Washington, D.C. 20554**

**In the Matter of the Application from AT&T Corporation and Tele-Communications, Inc. Seeking FCC Approval for a Proposed Transfer of Control.** | **CS Docket No. 98-178**

**Ex Parte Comments of**
**Dakota Telecommunications Group, Inc.**
**29705 453rd Avenue**
**P.O. Box 66**
**Irene, South Dakota 57037-0066**

Dakota Telecommunications Group, Inc. (DTG) is becoming increasingly frustrated and alarmed by the actions and arguments of a Tele-Communications, Inc. (TCI) subsidiary, Bresnan Communications Corporation (Bresnan), which in DTG's view are intended solely to impede DTG's entry into the cable system markets where Bresnan is the incumbent provider. These actions by Bresnan are currently focused on the franchise approval DTG received for the City of Marshall, Minnesota, which is a community DTG will use as a hub for providing competitive cable services to several communities in southwestern Minnesota. If the activities of Bresnan are an example of the corporate policies of TCI, then the combination of TCI with the resources and market presence of AT&T does not auger well for competition, especially in the rural markets where DTG seeks to compete.

A brochure describing DTG's market strategy is attached as Exhibit 1. A core strategy relies on the grant of a cable system franchise in the community. DTG uses that franchise to construct its own cable system and telecommunications facilities to provide its service package over either a hybrid fiber-coaxial plant or a hybrid fiber-coax-twisted copper plant. Also critical is the fact that this part of the country has a limited construction season. Blocking a company from placing facilities during the limited construction period delays the advent of competition at least one full year.

Bresnan has gone to extremes to oppose DTG's entry into the Marshall cable and telecommunications market. Bresnan opposed the granting of a franchise on the grounds that Dakota Telecom, Inc. (DTI), DTG's competitive subsidiary, is not financially fit to provide service; that competitive entry in a market the size of Marshall is doomed to fail; and that competition will "irresponsibly undermine" Bresnan's contributions to the community as a corporate citizen (Exhibit 2). Thus, contrary to the constant barrage from AT&T and TCI of the benefits of competition, the incumbent provider (TCI's subsidiary) sends the message that competition is evil and of little or no benefit. DTG vigorously and pointedly refuted all of Bresnan's challenges (Exhibit 3). Bresnan appealed the franchise grant to the Minnesota Court of Appeals and sought to stay implementation of the franchise pending appeal (Exhibit 4). Bresnan also sued the City of Marshall alleging wholly unfounded claims of violations of Minnesota's open meeting and access to information laws asking that the DTG franchise ~~be~~ voided. When DTG sent an open letter to the citizens of Marshall explaining that these legal maneuvers necessitated a delay of the Marshall construction schedule, Bresnan sued DTG for, among other things, defamation and tortuous interference (Exhibit 5). Additionally, Bresnan is the only opponent of DTI's certification by the Minnesota Public Utilities Commission as a facilities-based local service provider in Minnesota. Bresnan does not provide facilities-based local exchange telecommunications services in Marshall or anywhere else in Minnesota and has no immediate plans to do so. Bresnan then appealed the certification grant to the Minnesota Court of Appeals (Exhibit 6).

When viewed in context, and when the matters raised in litigation are reviewed objectively, the actions of TCI's subsidiary demonstrate a conscious, determined effort to block competitive entry. If a company the size of DTG, in such a rural and remote market, is seen as such a significant competitive threat by TCI that it is willing to dedicate this kind of effort and resources to block competitive entry, one has to wonder what behavior the industry can expect from a combined AT&T/TCI in more lucrative and populous communications markets?

Respectfully submitted:

William P. Heaston
General Counsel
Dakota Telecommunications Group, Inc.
29705 453rd Avenue
P.O. Box 66
Irene, SD 57037-0066
(605) 263-7212
February 18, 1999

**Exhibit 1**

# MARSHALL
# ARE YOUR COMMUNICATIONS POINTED in the RIGHT DIRECTION?

## Customer Care

DTG is investing heavily in today's

## Local Service

most advanced technology in

## Long Distance

order to provide your family,

## Cable Television

your business, your school and

## Internet Access

your community the best integrated

## Communications

communication services available.

## Operator Services

Our team is working with the best.

## Enhanced Services

**Shouldn't you?**

Tradition

Technology

Talent

Teamwork

TRANSFORMING COMMUNICATIONS

DTG can trace it's roots back to 1902, when the Hurley Telephone Company was formed to service rural Turner County in South Dakota. Since then we've grown and changed our name to DTG, but the commitment to bringing urban communication technology to rural communities is still the same.

The communities we service can testify to our commitment to community service, which is only getting larger as we enter an era of distance learning, community web sites, and of course, our sponsorship of civic organizations and events.

We have built the most technologically advanced network in the region and hired a very talented team of professionals to apply that technology to the needs of the communities we service.

At DTG we understand the need for teamwork within communications and within communities. It's this teamwork that will ensure success for our company, our communities, and our customers.

## Local Service

Caller ID
Call Forwarding
Last Number Redial
Call Waiting
Centrex
Conferencing

## Enhanced Services

Cross Product Discounts
Telemanagement Reports
Multiple Invoicing Media
Broadcast Fax
Conference Calling
Voice Mail

## Operator Services

Hotel/Motel
Hospital/Medical
College/University
Institutional/Prison
Pay Phone

## Customer Care

One Point of Contact
On-Line Bill Reference & Printing
Contact Logs
7x24 service
Customized Invoice Messaging
Multiple Billing Cycles
Newsletters

# DTG Integrated Communication Services

## Long Distance

1+ Products
800/888 Services
Dedicated Products
Travel Cards
Local Point of Presence
Pre-paid Cards
Private Lines
Business and Residential Service
Call Tracking by Code

## Cable Television

60 Channels
2-Way System
Premium Packages
Pay Per View
Advertisement Insertion

## Internet Access

Dial-up Service
56K and T-1 Service
E-mail & Broadcast E-mail
Newsgroups & Chat Rooms
Site Management
Enhanced Traffic Reporting
Business & Residential Modem Pools
Game Servers and Special Events

## Communications

WWW Development
Database Integration
WWW Application Development
On-Line Marketing
Corporate and Product Identity Design
Marketing Communications
Marketing Planning
Direct Mail

DTG
Dakota Telecommunications Group

**1-888-269-4DTG**

DTG

Dakota Telecommunications Group

# Exhibit 2

LARKIN, HOFFMAN, DALY & LINDGREN, LTD.
ATTORNEYS AT LAW

1500 NORWEST FINANCIAL CENTER
7900 XERXES AVENUE SOUTH
BLOOMINGTON, MINNESOTA 55431-1194
TELEPHONE (612) 835-3800
FAX (612) 896-3333

Jane E. Bremer
DIR. DIAL (612) 896-3297
E-MAIL jbremer@lhdl.com

April 6, 1998

received
4-6-98

Mayor Byrnes and Members of the City Council
Marshall City Hall
344 West Main Street
P.O. Box 477
Marshall, MN 56258

**Re: Cable Television Franchise in Marshall, Minnesota**

Dear Mayor and City Council Members:

Please be advised that we represent Bresnan Communications Company ("Bresnan"), the incumbent cable television operator for the City of Marshall ("City"). The purpose of this letter is to formally comment on the proposal from Dakota Telecommunications Group ("DTG") to obtain a cable television franchise in the City.

Bresnan is committed to providing the best possible service to its Marshall customers over the long term. Bresnan's goals are not impacted by the current presence of competition nor will they be by any future competitor. Bresnan's purpose in participating in this process is to assure parity among prospective competitors and adherence to the law which applies to cable operator and cities.

In summary, Bresnan's position is that the City should deny the application for a cable television franchise submitted by DTG as a financially risky, technically inexperienced, legally insufficient, and highly speculative venture. Moreover, DTG has submitted an incomplete application that fails to meet the minimum statutory requirements imposed by Minnesota law and therefore, its application should be denied. Finally, DTG's refusal to respond to legitimate questions regarding its qualifications raises serious questions about DTG's business intentions. Our rationale and evidentiary support is as follows:

1. **DTG's proposal does not comply with Minnesota Statute § 238.081 subd. 4, which is a minimum legal requirement in Minnesota**. Attached as Exhibit A is a summary of the requirements of Minn. Statute § 238.081 subd. 4 and DTG's corresponding responses and our comments as to the inadequacy of their responses. Minn. Stat. § 238.081 subd. 4 provides that the City shall require that any proposals for a cable communication franchise be notarized and contain at least the following information: (a) plans for channel capacity; (b) a statement of the television and radio broadcast signals; (c) a description of the proposed system design and planned operation; (d) the terms and conditions under which particular services to be provided to governmental and educational entities; (e) a schedule of the proposed rates; (f) a time schedule for construction of the entire system; (g) a statement indicating the applicant's qualifications and experience; (h) an identification of the municipalities that the applicant either owns or operates other cable communications systems; (i) plans for financing the proposed system; (j) a statement of ownership; and (k) a notation and explanation of any omissions or variations.

ATTACHMENT "C" - 6 pages

though DTG reports that they operate in 3 states and 26 communities, they do not provide cable television service to any community with a population anywhere near that of the City and in fact their total estimated subscribers in Minnesota comprises only approximately 27% of the City's number of subscribers. DTG does not have the experience or track record to serve a community the size of the City.

3. **DTG is not financially solid and its refusal to answer legitimate questions posed by the City's consultant raised serious concerns regarding its qualifications and business practices.** Although the application is incomplete, what DTG has presented establishes that the company cannot be found financially qualified under Minnesota law. Exhibits C and D attached provide summaries of the company's current financial status based on their information presented. Highlights are:

   a. DTG's leverage ratio (a common measure of how highly leveraged a company is compared to its cash flow generating ability), or the ratio of its long-term debt to its operating cash flow, stood at more than 17 to 1 per the Company's 12/31/97 financial statements. (The positive or negative effects of DTG's year-end acquisitions could not be determined from their financial disclosures.) Additionally, only $94,000 of additional loan capacity existed at 12/31/97. These ratios are well outside of industry lending practices.

   b. DTG's current loan with RTFC (dated June 24, 1997) restricts its proceeds to telecommunications services; cable television services are not mentioned.

   c. Historically, Rural Telephone Finance Cooperative ("RTFC") funds have not been available for competitive purposes.

   d. Historically, past efforts to raise capital by selling stock have fallen far short of expectations. DTG'stock offering sold a mere 19,485 shares of 400,000 offered and raised only $243,562 of the $5 million sought. (See post-effective Amendment to Form SB-2, filed April 2, 1998.) As of 3/31/98, there is no public market for DTG's shares. (See Form 10K SB for Fiscal Year End December 31, 1997, filed March 31, 1998.)

   e. DTG says they will finance design and engineering with cash flow and working capital. With more than $30 million of debt at 12/31/97 and only approximately $1.7 million of operating cash flow, how will they dedicate any of their cash flow to this effort?

   f. DTG generated a total of only $272,000 in operating cash flow from $1.9 million of cable revenues in 1997, reflecting a full year of operations of their acquired cable systems. This 14% operating margin is well below the industry average.

   g. DTG's debt increased 90% to more than $30 million from 1996 to 1997; its operating cash flow decreased over the same period and totaled only about $1.7 million in 1997.

   h. With so much debt as 12/31/97 compared to its cash flow and net losses, DTG also disclosed that their existing business required an additional $37 million of capital spending in 1998, which would require additional long-term financing. While they indicate their only source of financing, the RTFC, has indicated it would provide additional financing, note that the RTFC must approve any additional financing that DTG may seek from any source. If

5. **DTG has not been subjected to the same diligent inquiry which Bresnan was when it acquired the Marshall Franchise.** Attached please find Exhibit E which outlines the requirements imposed on Bresnan when it purchased the City's cable system from Time Warner which have not been imposed on DTG. The City and their legal counsel extensively reviewed Bresnan's financial, legal, technical, and other qualifications and consented to the transfer of ownership whereby Bresnan assumed the franchise. The analysis of DTG, by contrast, is cursory at best. Naturally, a higher lever of inquiry is imposed both by law and common sense on a system builder versus a buyer because of the horrific disruption and risk construction imposes and the lack of current revenues to pay for it.

6. **The economies of a second franchise do not work.** It is a fact that second franchises have been attempted and that the result has been financially devastating for all parties involved. The effect on a city when a second franchise fails is not only a financial strain, but also the constituents question the responsibility and role of city government in allowing such a situation to occur. A summary of the risk factors of a second franchise is attached as Exhibit F.

7. **There is absolutely no bar to denial of a franchise to an unqualified and unresponsive applicant.** In addition to requiring a complete application, Minnesota law requires a factual finding of legal, economic and technical qualifications for any company seeking a cable television franchise. See Paragraph 1. Similarly, federal law provides that a lack of legal, economic or technical qualifications are reasonable grounds for withholding a franchise. No law mandates that the City grant a business license to an unqualified and unresponsive applicant. See Exhibit G attached.

8. **Bresnan Communications Company is a proven industry leader who has made a substantial contribution to the City and whose investment could be irresponsibly undermined by a decision to authorize an unqualified competitor.** Bresnan was founded in 1984 by William J. Bresnan, then president of one of the largest cable operators in the U.S. and an industry pioneer who played a key role in the country's first satellite transmission and first fiber optic communications system. Today the cable television and telecommunications company serves some 214,000 customers in some 220 communities in the U.S. Largely concentrated in the Upper Midwest, Bresnan focuses on small and mid-sized markets in Minnesota, Michigan and Wisconsin. The Company acquired its first Minnesota cable system - Duluth - in 1988, and further expanded its presence in the state with the purchase of systems in Marshall, Mankato and Montevideo in 1994. Deeply committed to ensuring that its cable customers have access to advanced technology and programming services, the Company has invested substantially to rebuild the large majority of its cable systems, including Marshall, to incorporate a state-of-the-art Hybrid Fiber-Coaxial (HFC) network architecture. Today, some 87% of Bresnan's customers are served by HFC technology. As a result of the Company's investment, Marshall customers will have access to new cable services and a sophisticated high-speed Internet network. Also active in various international markets, affiliated Bresnan companies hold interests in partnerships providing cable, telephone and

# Exhibit 3

Dakota Telecommunications Group

Friday, April 10, 1998

Michael Johnson, City Administrator
City of Marshall
344 West Main Street
Marshall MN 56258

Tradition
Technology
Talent
Teamwork

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SUITE #404
SIOUX FALLS, SOUTH DAKOTA
57104-6711

605.335.8825
888.269.4384
FAX 605.335.3942

www.dtg.com

Dear Mike:

It now seems like ages ago, but it was only last December that leaders of this community invited me and my company to come to Marshall and talk about the future. We listened to everybody from the City Commission to their bosses—the people they represent. Then we presented a proposal to build a revolutionary new communications infrastructure within this city.

Since then, we have provided an extraordinary amount of information to the Council, to the Council's counsel, to the Cable Commission, to community leaders, to PrairieNet, to the local newspaper and radio stations, to curious individual citizens, and even to the incumbent cable and telephone providers—who are understandably nervous about our presence here. Our original HFC proposal itself included an encyclopedic collection of prices, plans, technical specifications, corporate strategy, and company values that many towns have been unable to squeeze out of their long-time incumbent providers after years of trying.

Although we have gone to great lengths to clarify and explain our original proposal, the proposal remains unamended. Our promises to this community remain unadulterated. And our strong desire to help build the future here remains undiminished.

In scrutinizing our complex application, the City Council has done an admirable job of finding that common sense middle ground between carte blanche authority and paralysis by analysis. My company has responded promptly and candidly to many, many data requests, and my days in Marshall have seemed like a record-length appearance on the Quiz Bowl. The City's engineers and technicians have met several times here in Marshall with DTG's engineers, pouring over diagrams and driving all over town together. City leaders have also paid several visits (some unannounced) to DTG's customers, facilities, and offices. (And those are just the ones we know about!) The record clearly shows that DTG has the managerial, technical, and

financial qualifications to earn the right for a chance to provide the local consumers a competitive choice.

Essentially, Mike, the City Commission's decision on granting a non-exclusive, fully competitive cable TV franchise to DTG all boils down to this: Do you want competition?

There is an old saying that there are some towns too small for one lawyer, but there are no towns too small for two lawyers. Marshall is neither too small nor too big for two cable companies and two phone companies, especially when the first real competitor on the scene is both a cable company and a phone company (and a whole lot more).

Some amazing coincidences have already happened in other places where DTG is seeking to provide spirited competition. In one town, the incumbent phone company gave 12 letter jackets to the high school sports program and $25,000 to the local hospital. So we gave a new TV and VCR to the high school sports program and $30,000 to the local hospital!

In another town, the incumbent phone company dropped its monthly residential rate to $10. We are countering by offering a five-cent toll plan within all of DTG's 18 exchanges--plus unlimited Internet access for $14.95 a month--plus 45 channels of cable TV (including two premium channels) and a converter box and a remote for $29.95 a month. Are Marshall's consumers enjoying that kind of attention now? Are they enjoying those kinds of prices now?

In another town, the incumbent cable provider has suddenly filled the local newspaper with ads touting the "advanced technology" of its HFC system, its "futuristic high-speed data transmission", and its "state-of-the-art fiber optic network". I am sometimes tempted to think that it has plagiarized DTG's proposal, but I guess the local paper is delighted with the substantial surge in advertising revenues--and the prospects of even more. Anyway, since no customer likes to be taken for granted, it's nice to see that the incumbent company has fallen in love with its old town all over again.

In yet another town, right after we delivered about $100 of HFC proposal booklets, the incumbent cable provider abruptly announced that it was going to spend over $6 million to upgrade its system right away. I was so impressed with that genuine expression of community spirit that I mailed the news article about it to community leaders in every other town in which that cable company provides its services. As long as I am helping spend lots of DTG's money, I might as well help other companies spend lots of their money, too.

If you think that the mere threat of good old-fashioned competition really stirs things up, wait till you see what competition itself does. You ain't seen nothing yet.

DTG
Dakota Telecommunications Group

April 10, 1998

Honorable Mayor Robert Byrnes and Members of the City Council
Marshall City Hall
344 West Main Avenue
P.O. Box 477
Marshall, MN 56258

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FAX 605.335.3942
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RE: DTG Cable TV Franchise Application

Dear Mayor Byrnes and Council Members,

At the open meeting of the Council on the evening of April 6, 1998, Bresnan Communications Company ("Bresnan"), through counsel, provided the Council with a letter and certain attachments in an attempt to discredit the application of Dakota Telecommunications Group ("DTG") and its subsidiary Dakota Telecom, Inc., for a competitive cable TV franchise. The following is a brief response to that letter and the relevant attachments (Tabs 1 and 2). Also enclosed are responses to questions from Council Member Mr. Boedigheimer (Tab 3), responses to questions from the Marshall Cable Commission represented by Ms. Robin B. Chaney (Tab 4), and letters of support from RTFC, Entrenet, and Houlihan Lokey (Tab 5).

The following responses correspond to the paragraph numbers in Ms. Bremer's letter:

1. DTG and Dakota Telecom have complied with the provisions of Minnesota Statute § 238.081, subd. 4. There is ample factual support in the application, as will be demonstrated hereafter. The sufficiency of the factual support, and compliance with statutory requirement, must be determined in the context of the entire state statute, not just one subdivision. Minnesota Statute § 238-084 contains the required contents of the Marshall city ordinance which grants the franchise. The requirements of that statute indicate that the information provided in the application may not necessarily be that concrete. For example, the ordinance can either contain the current subscriber charges or may only require that the charges be available to the public for inspection (subd. 1(g)(1)).

2. DTG and Dakota Telecom are relatively small telecommunications companies, but with significant hands-on experience in providing cable TV service to rural communities such as Marshall. DTG built within the last year, on time and within budget, new 750 MHz cable TV systems in four South Dakota communities (Centerville, Viborg, Harrisburg and Tea). DTG had previously built new cable TV

Sincerely,

Jackie Fowler

~~Jackie~~ Fowler
HFC Project Manager

Copies: Mayor Robert Byrnes
Marshall City Council Members
Brian Grogan, Moss & Barnett
Jane Bremer, Bresnan Communications
Jim Tate, the Marshall Independent

investment bankers (Tab 5), makes this very clear. The small scale of DTG's recent offering was expected. The offering was self-underwritten and limited to DTG's existing shareholders. It was made to honor commitments made by management to cooperative members at the time of the conversion into a public company last year. DTG planned only to cover offering expenses and was successful in doing so. This offering is not an indication of DTG's ability to raise funds from the open capital markets, as the Houlihan Lokey letter demonstrates.

This point also conveniently ignores the fact that DTG successfully raised $4 million in equity at $12.50 per share in December 1997 in connection with its acquisition of DataNet. It also presumes that DTG must raise funds using its common stock to finance the Marshall project, which is untrue.

Item 3(e). DTG is already dedicating internal cash flow to the project as evidenced by its responses to the City's information requests, its presence in the Marshall community, and its ongoing engineering and design efforts. Also, DTG has immediately available to it $5 million in new financing from RTFC to cover its working capital requirements. Again, the analysis errs by not analyzing new revenues from DTG's internal growth and 1997 projects.

Item 3(f). The systems purchased by DTG in 1996 were in very poor shape due to neglect by their prior owners. DTG's 1997 CATV operating results reflect extra operating expenses incurred by DTG to upgrade these operations, to the great delight of the customers located in these communities. In fact, this performance was well ahead of DTG's budget.

Item 3(g). This comment is entirely misleading because it ignores the additional revenues generated by DTG's internal growth and planned growth from its 1997 projects. See 3(a) and 3(e), above.

Item 3(h). Again, it is not appropriate to compare past cash flows to present debt. The mention of DTG's net losses is entirely misleading because these losses are primarily caused by DTG's voluntary election to increase its depreciation rates to write-off obsolete equipment and plant assets, which has no impact on past or future cash flow or on DTG's ability to raise funds for the Marshall project. DTG believes that all telephone and cable companies, including Bresnan and its parent company, TCI, will be forced to take these same steps in the near future due to the pace of technological change in the industry.

The statement as to RTFC's reaction to additional financing is totally unfounded speculation. RTFC does not prevent DTG from raising additional funds and, in fact, encourages DTG to do so. RTFC is fully aware of DTG's development plans, including its additional debt and other financing plans, and, as the enclosed letter demonstrates, fully supports DTG's plans. It specifically supports DTG's plans to build its planned project in Marshall.

4. DTG has not overextended its capital. DTG already has in place $5 million of immediately available financing. In addition, DTG's investment bankers believe that an additional $20 million in equity can be raised this year. Coupled with its own internal cash flow, DTG can easily cover the capital requirements suggested by Bresnan.

5. DTG has been subjected to the same diligent inquiry that Bresnan was at the time it replaced Time Warner as the cable TV franchisee. Attached at Tab 2 is

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5. DTG has been subjected to the same diligent inquiry that Bresnan was at the time it replaced Time Warner as the cable TV franchisee. Attached at Tab 2 is

the point by point response to Bresnan's Exhibit E. There is also no legal basis for the statement that DTG is subject to greater scrutiny because it is building a competitive system rather than acquiring an existing system. Bresnan talks about a "level playing field" and "nondiscrimination" but suggests that the treatment of DTG should be more onerous than that of Bresnan. There is also no factual basis for the use of words like "horrific" to describe competitive entry by DTG. The only obvious "horror" is that demonstrated by the reaction of Bresnan when faced with the reality of competition.

6. This entire analysis misses the fundamental nature of the advanced telecommunications system proposed by DTG. The simple fact is that the traditional financial and economic models used by incumbent cable and telephone companies have changed dramatically. DTG can now offer both types of services over one facility built at a cost which DTG believes, based upon its actual development experiences in 1997 and its proprietary independent engineering studies, is substantially below the combined cost of the existing facilities. Over this system, DTG is able to offer better, more advanced services to the residents of Marshall at a price below existing prices. DTG's costs are simply lower.

To view the economics of DTG's proposed projects from simply a cable perspective is highly misleading. DTG's anticipated revenues are also projected to come from telephone and other ancillary services. DTG uses detailed, month-by-month development budgets to build and operate its projects. Each project can justify itself on a stand-alone basis independent of any other planned developments using only the cash flows generated by the project. DTG believes that it has structured a win-win-win situation. DTG shareholders, investors, and bankers receive adequate returns, Marshall residents receive more and higher quality services at lower prices, and Marshall itself enjoys continued economic growth supported by a state-of-the-art telecommunications system.

The alleged risk factors discussed at Exhibit F are an interesting grouping. From the litany of dire predictions (e.g., rates will increase, competitors will take customers from existing operators, cost efficiency will be difficult, and the quality of service will suffer), the conclusion is made to seem inevitable that competition is doomed to fail, and that a Bresnan monopoly is the only viable solution. If you buy into this rationale, then competition will never work. Is the entrepreneurial drive that made and sustains this country is an illusion? That is obviously not the case in general, and certainly not the case with regard to the provisioning of cable TV service in Marshall.

7. DTG is encouraged by the legal conclusion provided by Bresnan in its Exhibit G. DTG would understand Bresnan's conclusion to be that it could not sue the city if the city grants the franchise. DTG can assure the city that it has no intention to litigate this matter. DTG will focus its efforts and activities upon fulfilling its legal obligations to the city so that the city can provide and enforce the appropriate franchise ordinance.

8. The fact that Bresnan may be a proven industry leader, may have made an unspecified substantial contribution to Marshall, or that its investment in Marshall may be at risk by the franchising of a competitor is legally irrelevant and factually of little importance. DTG has no quarrel with Bresnan's business ventures, its quality of

service, its corporate culture, or its commitment to being a good corporate citizen. DTG is pleased that Bresnan and its partners have 330,000 customers in Poland and 230,000 customers in Chile. DTG has no plans to serve customers in either country. DTG wants to serve the citizens of Marshall, provide quality cable TV and other modern state-of-the-art telecommunications services to those citizens, and have the opportunity to prove its worth to the economic and civic well-being of Marshall.

If you have any questions or wish to discuss any of DTG's responses further, please contact me. Thank you for your consideration of our Application.

William P. Heaston
General Counsel

Attachments
Cc: Michael Johnson, City Administrator
Brian Grogan
Jane E. Bremer

Tab 1

**DTG's RESPONSE**
**to Bresnan's Exhibit A**
**Comparison Of Minnesota Statute Section 238.081 Subd. 4 To**
**DTG's Request For Cable Television Franchise**
**In Marshal (sic), Minnesota.**

This response is based on the provisions of the Minnesota Statute. The numerical references are to the specific paragraphs of the § 238.081, subd 4.

**Subd 4(1).** Bresnan does not dispute that DTG has met this requirement. It only questions DTG's ability to activate a 750 MHz system (DTG has built and activated four such systems). The statutory provision does not require DTG to specify whether the channels are forward or reverse, video or other channels, how 300 channels are technically achieved, or what additional investment is required to activate additional channels. If the City of Marshall believes this information is necessary, DTG will endeavor to provide it.

**Subd 4(2).** The statute requires a "statement" of the channels for which FCC approval will be sought. While Bresnan's counsel attempts to paint DTG's comments as "vague and not definitive," what could be more specific and defined than the statement from DTG's March 13, 1998, filing, "DTG plans to offer consumers in Marshall all of the off-air television channels that are now provided in Marshall by the incumbent cable television company?." This requirement has been met.

**Subd 4(3)(i).** The statute requires the information about the general location of antennae and the head-end, <u>if known</u> (emphasis added). The sites are not known, and the DTG application indicates that those discussions are ongoing. This statutory provision has been met.

**Subd 4(3)(ii).** The statute requires that a schedule for activating two-way capacity be provided. There is no requirement that DTG commit to a specific time frame. DTG would submit that it is impossible to commit to anything more than what was committed to in its application. The statute has been met.

**Subd 4(3)(iii).** This statutory provision has been met. The only objection Bresnan has is that we do not provide those services now. Not only is the objection irrelevant, the statement is not factual. DTG currently provides those services in the South Dakota communities of Centerville, Viborg, Harrisburg and Tea.

**Subd 4(3)(iv).** Bresnan concedes that this statutory provision is met.

**Subd 4(3)(v).** DTG's application complies with Minnesota law. Advertising space will be sold on DTG's access channel, not on the City of Marshall's community access channel. Since DTG's application (provided on March 13, 1998) discusses qualified applicants, free services, set-up fees, recurring charges, and discounts, DTG has provided "a detailed description of how this will be implemented".

**Subd 4(4).** This statutory provision has been met. Free is free. All is all. Those are the terms and conditions for service to governmental and educational entities.

**Subd 4(5).** DTG's application meets this requirement as indicated in the statements provided by Bresnan. DTG will provide more than 40 channels for $24.95 per month, and there will be no additional charge for unusual or difficult installations. Additional information, if needed, is in the response to the Marshall Cable Commission (Tab 4). DTG does not understand the further reference to the subsidy of commercial installations, but the comment appears to be irrelevant to the purpose of the statute.

**Subd 4(6).** Bresnan does not contest that DTG has met this scheduling requirement. Bresnan questions DTG's ability to meet its schedule and grouses that "DTG has several other proposals pending to build similar systems." Bresnan's concern is irrelevant to complying with the statute.

**Subd 4(7).** Bresnan scorns DTG for having "only managed to attract" 5,700 cable customers, calling it "a very small number". DTG currently serves several hundred more cable customers (over 26 different jurisdictions) than Bresnan now serves in Marshall. What is relevant about DTG's current diverse customer base is that DTG does have the experience and expertise to provide cable TV service in the City of Marshall. Bresnan further states that "DTG has failed to respond" to this question about the "technical qualifications of the company and its personnel." DTG provided highly detailed biographical sketches of its top four technical employees who help design, build, and maintain its cable systems. Those four people have over 90 years of experience in the industry. DTG was clearly responsive to the statutory requirement.

**Subd 4(8).** Bresnan concedes that DTG has met this statutory requirement.

**Subd 4(9).** This statutory provision only asks for the "plans" for financing system construction. Those plans have been provided, and this provision has been satisfied. In addition, the Bresnan analysis is factually wrong and cannot have any weight in the consideration of this application. The working capital financing proposed by DTG is, in fact, already in place. As noted in DTG's audited Consolidated Financial Statements in Note 4, on page S-25 of the 1997 Annual Report to Stockholders, DTG has a $1.5 million line of credit with RTFC available to support its activities. As of March 31, 1998, $1.5 million remained undrawn and available for use. In addition, DTG has signed and has available for immediate use the $4 million additional line of credit discussed in its application. Finally, the perception of the RTFC participation fostered by Bresnan is totally divorced from reality. RTFC accepts the construction of hybrid fiber systems for both telephone and cable services as an appropriate use of proceeds under the definition of "telecommunications services." RTFC is fully aware of DTG's past and anticipated use of the RTFC funding and is specifically interested in financing DTG's Marshall project (Tab 5).

## Tab 2

## DTG's RESPONSE
## To
## Bresnan's Exhibit E
## City of Marshall Requirements during the Bresnan Transfer
## Which Are Not Requirements of DTG

Point 1. Representatives from the City of Marshall have paid several visits (some unannounced) to DTG's customers, facilities, and offices. Those representatives visited DTG's new Class 5 digital switch, for example, and talked with the mayor of Viborg about the new HFC system that DTG built in his city. Several long-time customers of DTG's DataNet operation (like Schwan's and MCP) are located in Marshall and have participated in public meetings concerning our company and its proposal. DTG's HFC proposal booklet, distributed widely in Marshall starting last December, includes a full page of references for the company's regulatory compliance, financial strength, community outreach, economic development, long distance customer service, Internet customer service, Web development, and information management. If additional inquiry is deemed necessary, DTG will cooperate fully to provide any additional information.

Point 2. DTG has no former franchises. The City, in its RFP, even asked DTG to provide the names of outstanding franchises for which no system has been built. There are none of those, either.

Point 3. City leaders of Marshall have not only been aware of DTG's potential CATV franchises, they themselves have encouraged our company to pursue a strategy of regional development. In wide ranging discussions about Marshall's worker shortage ("job surplus"), local leaders stressed with DTG the absolute necessity of building a new infrastructure far beyond the city to reach Marshall's current and potential work force. Additionally, DTG has discussed a regional approach with members of Missouri Basin, which provides its 59 member cities (including Marshall) with electric power. Based upon that encouragement (and a substantial amount of demographic and economic research), DTG delivered HFC proposals to Luverne, Pipestone, and Worthington. DTG is aware of several subsequent contacts that those cities have had with Marshall.

Point 4. DTG has not been involved in any franchise litigation.

Point 5. DTG, unlike Bresnan, is not acquiring an existing system which may be changed. DTG is providing a totally new system, the details of which have been provided to the Mayor and the City Council.

Point 6. DTG has provided the same information for the past two years. Information for additional years would not be all that relevant because DTG's operations have expanded significantly since 1995. In any event, financial information for DTG is publicly available from DTG's SEC filings on the SEC EDGAR Web site.

**Subd 4(10).** This statutory requirement has been met, as is clear from the data provided in the application. After DTG specifically stated that Dakota Telecom, Inc., is the actual franchisee, Bresnan now asks DTG to clarify who the applicant is.

**Subd 4(11).** This is a catchall provision. Bresnan does not contest that this provision has been met; it merely once again repeats its doubts as to DTG's ability to perform. DTG has been beta testing and then deploying new technology for almost a century. DTG has built buildings. DTG has always hired employees locally. (Our HFC Project Director for Marshall was born there, attended grade school and high school there, and graduated from SSU.) DTG's fiber optic backbone covers all of southeastern South Dakota, already linking Sioux Falls, Yankton, and Verimillion. The new Class 5 switch (the most sophisticated of its kind in South Dakota) started serving DTG customers last autumn. Substantial proof of the company's ability to perform was included in the 30-page HFC proposal booklet which DTG submitted to the City last December.

Bresnan's allegation that "DTG is making commitments and representations without providing these services anywhere else" evidences a lack of knowledge of DTG's essential nature, values, and current network operations. DTG has a long and successful history of providing services that have not been provided anywhere else. As our HFC proposal states, we completed South Dakota's first REA telephone system (1954), installed South Dakota's first all-buried telephone system (1964), became the first South Dakota telephone company to expand into cable TV (1982), began South Dakota's first independent operator services business (1990), became South Dakota's first independent Internet services provider (1995), provided the first competitive local service in South Dakota (1996), completed South Dakota's first independent SONET network (1996), operated the first HFC network in South Dakota (1997), and became the first telephone cooperative in America to convert to a public corporation (1997). Given that track record, whenever this company promises to do something, both our customers and our competitors know DTG will deliver.

NEITHER DTG NOR DAKOTA TELECOM, INC. HAS MADE ANY SUBSTANTIVE AMENDMENTS IN THE PROPOSAL AFTER THE PROPOSAL WAS SUBMITTED TO MARSHALL, MINNESOTA, AND BEFORE AWARD OF THE FRANCHISE.

Point 7: DTG's initial HFC proposal stated, "Depending upon the ownership and operation plan chosen by the City, DTG could have a building, equipment, and employees in Marshall. With our physical presence, we would employ both customer service and technical support people, who would be hired locally." DTG's March 13 application states that, "DTG's policy for community access channels includes provision of free access to individuals and organizations for non-profit activities . . . DTG's staff assistance to these parties is provided free of charge." Moreover, the Marshall Cable Commission presented DTG with a list of written questions, one of which was, "What are DTG's plans for the access studio to house the equipment specified by the franchise? Co-locate with their office?" DTG responded to that question by stating that at this time, the access studio would probably be located in DTG's office building. We left the door open for offers of different locations that might provide even better service and access to local citizens.

Point 8. The City's RFP inquired about, "The number of channels and services to be made available for access cable broadcasting." Also, the Marshall Cable Commission asked, in writing, "How many access channels will be available to the City of Marshall?" DTG gave responsive answers to both questions.

Point 9. DTG now provides FM service in Lennox and Parker, South Dakota. While DTG does not know if Bresnan currently provides it in Marshall, and while it is not a legal prerequisite for a franchise, DTG will provide it if required.

Point 10. DTG's March 13 proposal states, "In Marshall, DTG would provide free basic cable television services to all municipal government buildings, including all Marshall Fire Department buildings. DTG would also provide free basic cable television services to all public library buildings and to all elementary and secondary public and private school buildings."

Point 11. If Bresnan provides a la carte programming, DTG will provide it also.

Point 12. Service quality is DTG's hallmark. DTG will provide service quality that meets and exceeds FCC and other governmental requirements.

Point 13: DTG's HFC proposal states, "Our surveys of local subscribers and our face-to-face meetings with them would determine the particular mix of channels." Yes, DTG will survey customer satisfaction.

Point 14: There are numerous references to DTG's "operations philosophy and system maintenance" in the documents that the company has provided to the City. A few examples will demonstrate:

> "With our physical presence, we would employ both customer service and technical support people, who would be hired locally. DTG's customer service would be toll free, 7x24x365, and staffed by human beings—not answering machines." (HFC proposal.)

"Over the years, Dakota employees have established a proud tradition of providing extraordinary service to all our customers. At times, DTG repair technicians have even driven snowmobiles through roaring blizzards to repair telephone lines. We are committed to providing that level of service to the consumers of Marshall." (HFC proposal.)

"Any unusual or difficult connections would be handled on a case-by-case basis, adhering to this company's policy of continually striving to meet the consumer's needs." (March 13 response to RFP. That response included detailed biographical sketches of DTG's top four technical employees who help design, build, and maintain our cable systems.)

Here, as in numerous instances, the City and its representatives did not need to ask formal questions of DTG because our company has, from the onset (and without prodding or prompting), provided relevant and complete information.

Point 15: There is no provision in City ordinance, Minnesota statute, or federal law that requires the franchising authority to ask exactly the same questions about DTG today that were asked about Bresnan several years ago. DTG has frankly resisted the temptation to compile a list of questions that it has been asked but which have never been asked of Bresnan. Likewise, we have resisted the urge to compile a long list of information that we have freely provided but which has never been provided by Bresnan. We eschewed these activities because we prefer to emphasize the real life, positive aspects of competition and new technology.

Point 16. DTG is sure Mr. Grogan will provide sound legal advice to Marshall based on the requirements of local, state, and federal law. Mr. Grogan does not need Ms. Bremer to instruct or counsel him on his responsibilities.

Dakota Telecommunications Group

Thursday, April 9, 1998

Tab 3

Councilman Michael Boedigheimer
City of Marshall
344 W. Main Street
Marshall, Minnesota 56258

Tradition
Technology
Talent
Teamwork

Re: DTG Financial Facts


SIOUX FALLS
140 NORTH PHILLIPS
SUITE #404
SIOUX FALLS, SOUTH DAKOTA
57104-6711

605.335.8825
888.269.4384
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www.dtg.com


Dear Councilman Boedigheimer:

Jackie Fowler requested that I write to you, responding to several questions you have regarding the Financial Facts summary Jackie prepared for the Council and other issues which came up in your meeting last Monday night. Please feel free to share this letter with other members of the Council who may have similar concerns. We also plan to include a copy of this letter in our formal response to the Council.

First, I would like to express my personal thanks and the appreciation of our entire Company at being invited by the City to present a competitive telecommunications development proposal. I am very proud to be working with a company as dynamic and innovative as DTG. I am certain that you will find our managerial, technical, and financial abilities more than adequate to provide Marshall with one of the most modern telecommunications infrastructures in the entire country. And it will be our pleasure to participate with you as your community grows and flourishes using this infrastructure.

DTG has a corporate policy of being as open and accurate as possible in responding to questions, especially inquiries from communities and city franchise authorities. We believe that this candor forms the basis for mutual trust and respect among all concerned and creates the environment for the close working partnership with city government necessary to provide outstanding service to the city's residents. Accordingly, I am very pleased to be able to respond to your questions.

**Stock Valuation**

Our $12.50 stock price was determined by our Board based upon our own internal and proprietary financial forecasting models, advice from our financial and valuation consultants, and arm's length negotiations with interested merger partners. In December of 1997, we concluded a $4 million merger agreement with DataNet, the region's largest independent network design company. The entire purchase price was paid in the form of our stock valued at $12.50 per share. The negotiations were lengthy, involving legal and financial advisors for both companies. As a result, we feel that the price and payment terms were fairly determined.

We also recently concluded a small offering limited to our existing employees and shareholders at $12.50 per share. Tom Hertz, our CEO, and I both purchased 2,000 shares in this offering at $12.50 per share. And we have had one director and several employees exercise stock options at the $12.50 per share price. Overall, we believe that this price is fair and reasonable.

Now, I agree that the ultimate test of the value of our stock will occur when we become actively traded in the NASDAQ market. We have been working hard to establish this market, and are awaiting decisions by several potential market-makers to start the process. However, we face some rather unusual challenges. To our knowledge, we are the first telephone cooperative in the country to convert to a public company. As a result, as of March 16, 1998, we had 8,117 shareholders holding or having the right to hold 2,500,517 shares.

As noted on page S-36 of our Annual Report, 3,818 holders have not yet completed the paperwork to receive their certificates, in spite of repeated attempts on our part to request their cooperation. The reason? They each own a very small number of shares. In fact, 3,398 of our shareholders hold "odd lots," (less than 100 shares), and this creates a potential problem for market-makers interested in trading our stock. We believe that the problem is not insurmountable, but it will take longer than we originally hoped to establish an orderly market. Fortunately, this does not stop us from accessing the public markets for additional funds. In fact, these offerings will actually help establish the trading market.

## Equity

I understand that you also have some concerns about the equity numbers cited in the summary. The reference to $10,809,551 in equity funds is composed of $8,523,870 in Common Stock and $2,298,006 in Other Capital, net of $12,325 in Treasury Stock. It is not a reference to net Stockholders' Equity of $7,804,072. The purpose of including this number was only to show our ability to raise additional equity through mergers and other transactions. As we noted, we added $5 million of this value in December of 1997 alone. Reducing the total number by our accumulated net loss seemed to me to make the $5 million new equity misleading as a percentage of total capital. I am sorry for any confusion that this may have caused you.

100% of the cable customers to make our project viable. Of course, that does not mean that we would not seek all of the customers! And we sincerely believe that if we provide better service at better prices, we would deserve to serve all of Marshall's citizens.

Given today's technologies, there is no need for any one company to serve all of the cable customers in any one town to remain viable, even in a community the size of Marshall. (You are, by the way, correct in asserting that Milbank, South Dakota, is now served by two competing cable companies—Otter Tail Power Company and TCI. According to our information, the sky has not yet fallen in Milbank!). Of course, the competitive companies must be willing to make the investments necessary to upgrade their facilities. The "risks" cited by Bresnan are simply the risks that they themselves face if they do not respond to our competitive challenge. That would be their choice. Our viability is certainly not in question. But such is the nature of competition. We have assembled a better mousetrap, perfectly suited to communities in our region. Your community and your residents will receive better services at lower prices. We cannot imagine that in the United States, a country which champions the operation of free markets and competition, we would be asked to stop innovating in order for an incumbent company to protect a *de facto* monopoly! It is also curious, is it not, that the only objection to our proposal comes from your incumbent cable company?

We really believe that we have structured a win-win-win situation. Our shareholders, investors, and bankers receive adequate returns, your citizens receive more and higher quality services at lower prices, and your community enjoys continued economic growth supported by a state-of-the-art telecommunications system. Even your existing service providers have the same opportunity to rebuild their facilities and enjoy the same advantages.

I hope that the foregoing information adequately answers your concerns. Please do not hesitate to let us know if you have any additional questions.

Sincerely yours,

Dakota Telecommunications Group, Inc.

By Craig A. Anderson

Craig A. Anderson
President/CFO

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I hope that the foregoing information adequately answers your concerns. Please do not hesitate to let us know if you have any additional questions.

Sincerely yours,

Dakota Telecommunications Group, Inc.

By Craig A. Anderson

Craig A. Anderson
President/CFO

Tab 4

# DTG's Response
# To
# Questions Prepared By The Marshall Cable Commission
# April 9, 1998

*Question 1: What specific channels will be in the original 60 offered?*

DTG's new cable television system in Marshall would have a total channel capacity of over 300 channels capable of being energized. Of that total, at least 60 channels would be energized immediately. This system would be similar to the 750 MHz systems that we now operate.

Attached is the Spring 1998 issue of DTG's Cable News. The back page of that document lists DTG's current cable channel lineup, including both basic service channels and premium channels. As our application states, DTG plans to offer consumers in Marshall all of the off-air television channels that are now provided in Marshall by the incumbent cable television company. The cable channel lineup in Marshall would also include at least one local community access channel. DTG's ultimate channel line-up in Marshall depends upon input from the city government and from other local consumers.

As you read the Cable News, you will recall that over our proposed HFC network, we will offer not only cable television, but also a full spectrum of other services. Note that our monthly residential telephone service is $12.75, and that our monthly business telephone service is $17.50. When a consumer has any other service from DTG (like cable TV), unlimited dial-up Internet access is $14.95 per month. Contrast these rates with what you are paying now.

***Question 2: How many levels/types of "channel packages" or tiers will be offered? What will be in each? What will each cost?***

DTG's monthly basic service in Marshall will cost $24.95 per month. DTG does not now offer a "basic tier" package of relatively few channels for a cost less than $10 per month. There has been very little demand for such a package in our current markets. If such demand exists in the Marshall market, DTG will certainly meet it with a competitively priced package. If the City requests that such a package be added, we will make it so.

As you can see from reading the Cable News, DTG now offers five different packages involving premium channels. For every premium channel you subscribe to, you get a second channel free. Subscribers to HBO get HBO II free. Showtime subscribers get Showtime II free. If you subscribe to STARZ!, we will give you ENCORE and ENCORE+ for free. When you have a converter box installed in your home, you can try all nine premium channels free for five days.

According to Bresnan's April 1, 1998, service sheet, Bresnan charges $11.95 per month each for HBO, Cinemax, Showtime, and The Movie Channel; with DTG, each of those premium channels is $7.95. For the combination of any two of HBO, Cinemax, Showtime, and The Movie Channel, Bresnan charges $19.85; with DTG, any pair of those is $13.95. Bresnan charges $6.95 per month for the Disney Channel; with DTG, it is free.

*Question 3: What will installation/hookup cost?*

Attached is a list of DTG's CATV installation charges. This is one of the actual sheets from which our customer service representatives work in dealing with cable customers. You may compare these prices with Bresnan's rate sheet for Marshall published on April 1, 1998. Bresnan's standard underground installation is $62.03; DTG's is $35.00. Bresnan's charge for change of service or adding premium service is $15.51; DTG's is $13.00. For additional outlet installation at time of install or move, Bresnan's charge is $15.51; with DTG, the first is free, and the second is $25.00. Bresnan's rental charge for a basic converter box is $1.00 per month; with DTG, there is no charge.

***Question 4: How long will it take for an individual to get hooked up? What will be the process?***

As the new HFC system reaches a particular consumer's location, and that location is wired, cable television service, including two-way capacity, will be available at that time. In DTG's current CATV towns, in most instances, cable service is provided on the same business day that a request is made, or on the following business day. Marshall consumers who desire CATV service can speak directly with work crews, or they can call DTG's new office in Marshall, or they can speak with DTG's HFC project manager for Marshall, Jackie Fowler, whenever they see her around town. All customer service calls (including installation requests) can be made without cost to the calling party.

***Question 5: Will there be a local phone number and person in Marshall for service and repair?***

As DTG's HFC proposal booklet states, "DTG will have a building, equipment, and employees in Marshall. With our physical presence, we would employ both customer service and technical support people, who would be hired locally. DTG's customer service would be toll free, 7x24x365, and staffed by human beings—not answering machines."

***Question 6: Where will the head end/offices be in Marshall?***

The ultimate locations for DTG's facilities have not yet been determined. DTG's engineers and outside plant specialists have made several visits to Marshall, scrutinizing blueprints, talking with the City's engineers, and inspecting various sites. At this time, there are several options under consideration. Because the formal franchise application process is continuing, DTG has left open final decisions on facilities placement, not wanting to foreclose on any options or opportunities that might yet arise, either from the City or from local entrepreneurs.

Bresnan has, of course, expressed consternation over the fact that DTG has not yet determined the ultimate location for its head-end facility. While it is true that final zoning details must be worked out, DTG does not have an adversarial relationship with Marshall's city government, and we are now in this city to provide its citizens better telecommunications services.

*Question 7: How many employees will be in Marshall? What will their jobs be? Will they be hired locally or brought in?*

DTG's HFC Project Manager, Jackie Fowler, lives in Marshall, where she graduated from high school and college. During the construction phase of the project, DTG will hire a considerable number of workers locally, with the actual number determined by the City's franchise directives, the expectations of local consumers, and, of course, a construction schedule controlled by Minnesota weather. When DTG begins offering services in Marshall, we will hire both customer service and technical support people. They will be hired locally. The ultimate numbers of those jobs will depend upon the response of local consumers to our services.

DTG's operations are, quite frankly, more labor intensive than those of many large corporations. Hiring somewhat more people and relying somewhat less on machinery does, of course, increase our operating costs. Those increased costs are, however, more than offset by the tremendous economies of scale created by providing both cable television and telephony services over the same network and through the same organization. Those increased costs are also offset by an incalculable amount of good will felt by customers who get treated like human beings.

DTG does not want Marshall's consumers to have to try to get service and solve problems by calling some faraway call center and talking with persons who have no direct contact with or knowledge of local requirements or conditions. Since 1902, DTG has excelled in providing good customer service in southeastern South Dakota because our employees were literally serving their neighbors. We likewise want our customers in Marshall to be served by their neighbors.

*Question 8: Has an FCC license been acquired for Marshall? If so, on what date?*

After the City has granted a non-exclusive CATV franchise to DTG, we then can and will apply to the FCC for an identification number for our operation in the city. The FCC also requires that we submit an annual report for each of the communities in which we provide CATV service.

*Question 9: Will DTG build an I-Net, as specified by the franchise?*

When Bresnan purchased the CATV system in Marshall, the company apparently inherited an institutional network that had been built by its predecessor according to the provisions of the original franchise agreement. The franchise requires the grantee to construct, operate, and maintain a two-way, fully active institutional network serving Marshall's high school, middle school, public and private grade schools, the Lyon County Public Library, and Marshall City Hall. The franchise goes on to describe, in considerable detail, the system's equipment, even including power inserters and cross-over filters. Although the original system that is still in place is apparently not without some utility, several local leaders have told DTG that it is underutilized because it is "basically an 8-track tape in a world of CD's".

In keeping with the letter of the franchise, DTG is prepared to construct, operate, and maintain an I-Net exactly as laid out in Bresnan's franchise. In keeping with the spirit of the franchise, DTG offers an alternative proposal. The City and DTG can determine the actual cost of DTG's construction of the I-Net, using the technology specified in the franchise. Then, under the City's guidance and to the City's satisfaction, DTG would use those funds (and potentially more) to construct, operate, and maintain a state-of-the-art fiber optic institutional network.

***Question 10: How many access channels will be available to the City of Marshall?***

DTG has promised to provide one community access channel to the City. If the City requests, DTG would certainly provide a second channel to the City. DTG's policy for community access channels includes provision of free access to individuals and organizations for non-profit activities (like fundraisers, community information messages, and public health and safety bulletins). DTG's staff assistance to these parties is provided free of charge.

***Question 11: What are DTG's plans for the access studio to house the equipment specified by the franchise? Co-locate with their office? Assist in design, maintenance, and placement? Other?***

At this time, DTG plans to house the access studio within its new office in Marshall. Other locations could still be considered, especially if they would appear to provide even better service and access to local citizens. Remember that DTG intends to provide CATV and telephony services to all consumers in Marshall. The new HFC network will be ubiquitous within the community. The universality of the network gives us many options in the placement of facilities. We continue to listen for advice from Marshall citizens on all aspects of the community access channel(s) and the facilities that support them.

***Question 12: Will there be the necessary equipment to put programming (not just teletext) on the access channels?***

That necessary equipment will be available. For almost a century, DTG has been providing telecommunications services in small towns and rural (even remote) areas. People who live in those areas rightfully regard the information provided through our services (television, telephone, and computer) to be important, sometimes crucial, to their lives. We thus view the full provisioning of local access channels to be far more than a minimum bureaucratic requirement.

*Question 13: DTG's materials mention having advertising space to sell on an access channel. Since this is not permitted on a community access channel, will it be put on an LO channel?*

On Marshall's community access channel(s), access will be available on a first-come, first served, nondiscriminatory basis. No advertising will be sold. Advertising space will be sold on DTG's access channel. For-profit enterprises will be charged a one-time set-up charge and then a daily recurring charge. Discounts will be given based upon the term of the advertising contracts.

Attachments: DTG Cable News, Spring 1998
DTG CATV Installation Charges

**DTG**

*Dakota Telecommunications Group*

# Spring Issue Cable News

Dakota Telecom is pleased to announce the introduction of its new advanced telecommunications services. Customers are now able to take advantage of local and long distance telephone, Internet and cable television services all from one company.

Dakota recently completed its major 1997 telecommunications project, which allows the company to offer the latest in high-speed video, voice and data services. It is a state-of-the-art digital system based on today's fiber optic technology.

The new facilities will connect users to high-speed internet connections, high-speed voice, digital and data services; direct fiber optic connections; and distance learning and telemedicine opportunities.

## NEW **PREMIUM** CHANNELS

**HBO** brings home the best! Get a new, never-before-seen-on-HBO movie every Saturday night, 52 weeks a year - Guaranteed! Plus, catch spectacular Big Events—award-winning HBO Original Movies, explosive World Championship Boxing, daring and fresh comedy...and you'll see all these great programs without commercial interruption! ***Subscribe to HBO and get HBO II for FREE!***

**SHOWTIME** is a 24-hour commercial-free premium service offering exclusive theatrical movies, great original pictures, comedy series and championship boxing. SHOWTIME features include comedy on Friday night, Hollywood premiers on Saturday and a new SHOWTIME Original Picture every Sunday.
***Subscribe to SHOWTIME and get SHOWTIME II for FREE!***

**CINEMAX** offers subscribers more movies than any other service, averaging over 170 titles per month. ***Subscribe to CINEMAX and get CINEMAX II for FREE!***

**STARZ!**'s programming line-up includes hit movies of today such as *Scent of a Woman*, *The Flintstones* and *Schindler's List*. STARZ! includes great movies from exclusive first runs to classic hits—programmed in theme blocks for children, families and even the film connoisseur. 120 commercial-free movies are scheduled every month, with no late night sex or violence. No "R" rated movies are shown until after 7 p.m., and a new movie is premiered every Saturday at 7 p.m.
***Subscribe to STARZ! and get ENCORE & ENCORE PLEX for FREE!***

**ENCORE**'s lineup includes hit movies from the 60s, 70s and 80s. Thirty movies are scheduled each month and are shown every two hours, commercial-free.

**ENCORE PLEX** (ENCORE+) programming lineup includes hit movies from 60s, 70s and 80s. ENCORE+ devotes each day of the week to movies and programs with specific themes—all commercial free:

**Sundays:** WAM! America's Youth Network
**Mondays:** Love Stories
**Tuesdays:** Encore
**Wednesdays:** Western
**Thursdays:** Action: Non-Stop Adventure
**Fridays:** Mystery
**Saturdays:** True Stories & Drama

**CHECK OUT DTG's great Cable Offers INSIDE!**

Corporate Advisors

April 9, 1998

To Whom It May Concern:

Dear Sir or Madam:

Entrénet Group, L.L.C. is a capital advisory firm that has been engaged by Dakota Telecommunications Group, Inc. (DTG) to advise them on capital acquisition strategies. Entrénet is comprised of a group of seasoned operating executives that have focused on the telecommunications industry and have assisted a number of companies in financing their on-going activities. We have enclosed a packet of information that will more fully describe Entrénet

Based on our due-diligence and our experience with the communications industry, we are confident that the strong management team and technical expertise DTG has developed will successfully be able to meet their objectives. The objectives we have become most familiar with include the rapid deployment of a hybrid fiber network that will provide state of the art communications to the communities that are selected for overbuilds by DTG. The financing for these projects individually should not pose any problem for DTG, as the individual projects would be financable on their individual merits. This is to say that each project taken individually provides an economic return that would be significant enough to secure "construction project" style financing.

DTG has the distinct advantage of being a 95-year-old company with experience in operating a variety of communications segments successfully. The company has successfully positioned itself to allow for the addition of significant capital infusions, as they are required. The company has chosen to secure financing for the entire entity to date as opposed to specific project financing. This has effectively reduced the cost of debt and equity and has strengthened the company's financial position.

The company has carefully developed its management team to provide the quality of service to its customers that the increasingly competitive communications industry demands. The management has been developed to provide this service in a cost-effective manner. The successful HFC installations and other operational milestones the company has been able to accomplish, just since our involvement, has clearly made DTG a leading provider of competitive communication services in the markets they are targeting in the Midwest.

We are pleased to be involved with DTG, and would be to be happy to provide any information or details that you may require.

Sincerely,

Ted Morgan
CEO

**entrénet Group LLC**
1304 Southpoint Boulevard, Suite 220 • Petaluma, CA 94954
*Tel*: 707.781.2500 • *Fax*: 707.781.2510 • *Email*: info@entre.net • *Web*: www.entre.net

RTFC

RURAL TELEPHONE FINANCE COOPERATIVE
2201 Cooperative Way · Herndon, Virginia 20171-3025
703-709-6700

March 27, 1998

**Tab 5**

Mr. Craig A. Anderson
Executive Vice President
Dakota Telecommunications Group, Inc. ("DTG")
P.O. Box 66
Irene, South Dakota 57037-0066

Re: DTG's Development Plan

Dear Craig:

I would first like to state that RTFC is pleased to be your lender. We have said before that DTG's openness and diligence in working with us has created a high level of mutual trust and confidence...this view remains unchanged.

Per our conversation, you requested that we review a long-term credit facility for the construction of cable TV plant in Marshall, Minnesota as one part of DTG's complete business and financing plan submitted to us several weeks ago. We have expressed from the very beginning, our interest in working with you on a financing package that will support your capital requirements for the next several years, and we remain firm in our desire to work hand-in-hand with you towards this end. As with any borrower, however, we will obviously not be in a position to offer a firm commitment until we can complete our underwriting and submit your loan request for final approval to RTFC's Board of Directors.

As a result of DTG's innovative plan to modernize and broaden its focus to become a full service telecommunications provider, in 1997 we extended $27 million under long-term debt commitments, thereby providing tangible evidence of our confidence in both your ideas and ability to execute your plans. As a measure of our interest in your new project, RTFC has already approved a $4 million construction line of credit for bridge financing, which is in addition to the $1.5 million line of credit that DTG already has in place.

We are well aware of the many challenges that DTG has faced over the past year as you worked to raise the standard of telephone and cable TV service in your communities. We've had the opportunity to review your preliminary operating statements and was pleased to see that DTG is meeting its challenges within budget and consistent with projections submitted last year.

Once again, let me emphasize that we are very pleased with our relationship with the management and performance of DTG and look forward to completing our due diligence on your current proposal in the near future. Should you have any questions, please feel free to give me a call at either 800/346-7095 or directly at 703/709-6793.

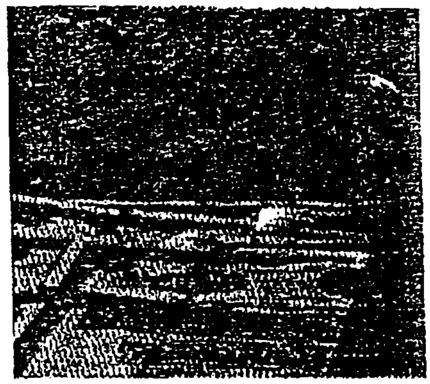
Sincerely

Ken A. Fried

Kenneth. A. Fried
Associate Vice President
And Account Manager

entrenet
*Corporate Advisors*

# ADVISORY OVERVIEW



## *Mission Statement*

**entrénet** Group, LLC is a full service corporate capital advisory firm dedicated to providing its clients with effective consultation, interim operating assistance, and optimum positioning in securing targeted financings, mergers or acquisitions at maximum client valuations through proven sources.

## *Financing Strategy Specialists*

**entrénet's** principals have extensive experience in the creation, development, financing, staffing, and execution of significant strategic growth concepts both as principal participants and as advisors. This experience assists **entrénet** in identifying quality emerging growth companies and in working with management to achieve their corporate vision.
The **entrénet** Group has established an enviable track record of successfully advising emerging firms on the most effective strategies to fund growth.

**entrénet** is committed to achieving client objectives in a responsive and professional manner. This is accomplished by providing clients with access to the financial tools necessary to fully realize their potential, while creating optimum shareholder value.

## *Maximizing Client Value*

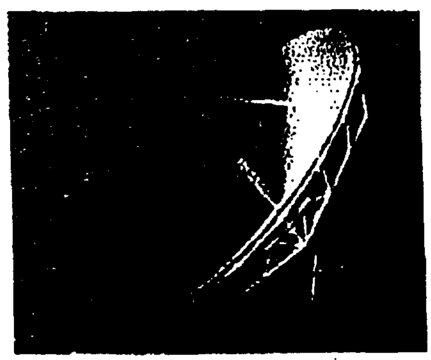
**entrénet** provides professional assistance in the positioning and "packaging" of corporate clients to achieve optimum value in the execution of financing objectives.

**entrénet** specializes in developing and presenting its client's key assets for maximum impact in the financing process, and then carefully selecting investment sources that match its clients' market profile.

## *Client Profile*

Clients served by **entrénet** have demonstrated their ability to succeed, but may now require additional financing to execute their full market potential.

Client companies generally exhibit the following characteristics:



- Visionary management
- Limited capital
- Technology based products and services
- Moderate book value
- Significant market potential
- Specialized distribution channels
- Strong case for expansion
- Financing requirements range from $5 million to $30+ million

entrenet
Corporate Advisors

## The entrénet Edge

The **entrénet** Group is committed to achieving client objectives as they compete for strategic positioning in an increasingly dynamic market environment. Extraordinary attention to detail along with exceptional access to a world wide network of financial and strategic corporate investors sets it apart from traditional advisory groups.

**entrénet's** preparation, responsiveness, focus and selectivity (undertaking few concurrent assignments) has enabled it to provide clients with the financing necessary to grow and compete effectively as we approach the 21st century.

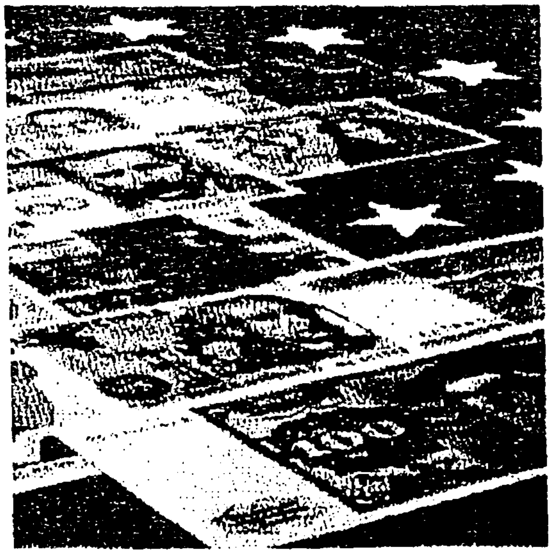
## Long Term Growth Partners

The **entrénet** Group provides client companies with much more than access to financing.

**entrénet** provides a broad range of services to assist companies in achieving their strategic objectives.

These services include:

- Business plan development
- Mergers and acquisitions
- Strategic partner development
- Market research analysis
- Financial analysis
- Joint venture development
- International expansion
- Licensing assistance
- Investor relations programs
- Management/Board recruitment
- Interim management
- Continuing counsel to senior executives
- Management Consulting



## Client Objectives Met

**entrénet's** successful completion of an engagement consistently results in meeting the client's financing requirements. This allows the achievement of new levels of earnings, while providing sound investor relations and profitable opportunities for the future.
**entrénet's** seasoned team of professionals work diligently to achieve this successful outcome through a network of "blue-chip" organizations which have been developed over the past fifteen years and is based upon direct personal relationships with top industry executives.

# HOULIHAN LOKEY HOWARD & ZUKIN CAPITAL

INVESTMENT BANKERS

April 9, 1998

To Whom It May Concern:

Pursuant to our engagement letter with Dakota Telecommunications Group, Inc. (the "Company") dated March 18, 1998, Houlihan Lokey Howard and Zukin Capital has been retained to raise, on a best-efforts basis, $20 million of cumulative convertible preferred shares (the "Financing") for the Company.

Among other things, we have conducted due diligence, reviewed the Company's business plan, and completed a private placement memorandum. Based on this investigation, we are confident in the Company's management and technical abilities. Further, we are very confident in our ability to raise the Financing and look forward to closing by June 1, 1998.

Sincerely,

James R. Waugh
Director

New York
31 West 52nd Street, 11th Floor
New York, New York 10019-6118
Tel 212.582.5000 Fax 212.582.7405
Broker/dealer services through
Houlihan Lokey Howard & Zukin Capital.

Los Angeles Chicago San Francisco Minneapolis Washington, D.C. Dallas Atlanta Toronto

The options call for delayed vesting so that 20 percent of each option became exercisable on July 25, 1997. Thereafter, an additional 20 percent of each option becomes exercisable on each anniversary date of the stock option agreements if the Optionees are then employed by the Company until the total number of shares subject to each option become exercisable. Thus, 40 percent of the options have become exercisable as of the date of this Proxy Statement. Each option remains outstanding for ten years from the date it was granted. The options are non-transferable.

Under the terms of the stock option agreements, the options are not incentive stock options under Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"). The options were not subject to tax when they were granted. Upon exercise, the Optionee will recognize compensation income in the amount of the spread between the market value of the options and the option exercise price. The Company will receive a corresponding deduction. The option price must be paid in cash or shares of stock of the Company, valued at the market value on the date of exercise.

On a fully diluted basis, assuming that all vesting periods and other restrictions contained in the options have been satisfied or lapsed and all the options were exercised in full, each Optionee would own approximately five percent of the total number of shares of the Company's outstanding Common Stock. The exercise price of the Company's Common Stock under the stock option agreements is $6.19 per share.

## FISCAL YEAR-END OPTION VALUES

| | Number of Securities Underlying Unexercised Options at Fiscal Year-End | | Value of Unexercised In-the-Money Options at Fiscal Year-End (1) | |
|---|---|---|---|---|
| Name | Exercisable | Unexercisable | Exercisable | Unexercisable |
| Thomas W. Hertz | 49,592 | 74,388 | $312,925.57 | $ 469,388.28 |
| Craig A. Anderson | 49,592 | 74,388 | $312,925.57 | $ 469,388.28 |

(1) Based on a market value of $12.50 per share at December 31, 1997, adjusted to reflect the two-for-one stock split.

During 1997, the Cooperative compensated its directors at the rate of $500 per regular monthly board meeting attended, $250 per special board meeting attended and $100 per special telephonic board meeting attended. In 1998, directors will also be compensated at the rate of $250 for attendance by teleconference at regular monthly board meetings. Directors also are provided with travel and accident insurance at a cost of $125 per year per director. Directors are eligible to participate in the medical reimbursement plan. These compensation arrangements were continued by the Company after the Merger in July 1997.

Under the Company's 1997 Stock Incentive Plan, each Non-Employee Director of the Company will be entitled to receive semi-annually, on June 30 and December 31 of each year, stock options to purchase 400 (as adjusted to reflect the effect of the stock split) shares of Common Stock at 100 percent of the market value on the date of grant. The stock options will be issued for a term of ten years. The formula grant provisions for Non-Employee Directors may be amended by the Board of Directors not more than once every six months, other than to comport with changes in the Code, the Exchange Act or the rules thereunder. Non-Employee Directors may pay the exercise price using previously held shares of Common Stock to the extent that other plan participants are permitted to do so.

In November 1997, the Board of Directors adopted the Director Stock Plan of 1997, under which each Non-Employee Director who has or will have served more than five years on the Board of Directors of the Company (including service as a director of the Cooperative) will receive a one-time award of 2,000 shares (as adjusted to reflect the effect of the stock split) of Common Stock. This award was payable on January 1, 1998 to directors who had previously served five years, and will be payable on the fifth anniversary of service to all other non-employee directors.

**Employment Agreements, Termination of Employment and Change in Control Arrangements**

*Employment Agreements.* The Cooperative entered into separate but substantially identical Employment Agreements ("Agreements") with its Chief Executive Officer and General Manager, Thomas W. Hertz, and its Executive Vice President-Marketing, Chief Financial Officer and Treasurer, Craig A. Anderson (the "Executives"). Upon consummation of the Merger, the Company assumed the Agreements according to their terms.

Each Agreement is for a three-year term of employment. However, the employment term under each Agreement will be automatically extended for an additional year at the end of each year, unless either party gives written notice that the employment term under the Agreement is not to be extended further, in which case the employment term under the Agreement will expire at the end of two additional years, except that the employment term under the Agreement will also be extended automatically for three years following the date of any Change in Control (as defined in the Agreements) occurring during the employment term under the Agreement. The current terms of the Agreements are until December 31, 2000.

The Agreements provide minimum salaries of $135,000 per year for Thomas W. Hertz and $100,000 per year for Craig A. Anderson, and also provide for an annual bonus to each of the Executives equal to fifteen percent of the increase, if any, in corporate net income over prior year net income. "Net income," for purposes of the bonus calculations, is pre-tax net income before depreciation, amortization and other non-cash expenses, before annual bonuses under the two Agreements and after eliminating the effect of extraordinary items. Under the formula, no bonuses were paid for 1997.

Under the Agreements, the Company or the Executive may terminate the Executive's employment at any time upon 30 days' notice. If the Company terminates the Executive's employment involuntarily during the term of the employment under the Agreements other than as the result of a Disability or for Cause, or if the Executive terminates the employment for Good Reason during the employment term under the Agreements, the Agreements entitle the terminated Executive to Severance Pay. "Disability" is defined as the Executive's inability to substantially perform his duties for a continuous period of nine months. "Cause" is defined as willful and continued failure by the Executive to substantially perform his duties after notice of the deficiency, or willful misconduct by the Executive that is materially injurious to the Company and occurs without good-faith belief by the Executive that the action was in the best interests of the Company. Termination for Cause requires the affirmative vote of two-thirds of the Board of Directors. "Good Reason" is defined to include: (i) a material breach by the Company of the Agreements or any other agreement with the Executive; (ii) assignment to the Executive of duties inconsistent with his position; (iii) removal of the Executive from his position; (iv) relocation of the Company's principal executive offices outside a 60-mile radius from Irene, South Dakota or any requirement by the Company that the Executive be located other than at the executive offices or that he engage in substantially increased job related travel; or (v) failure of the Company to obtain the agreement of any successor to assume the Agreements. The Executive may not terminate his employment with Good Reason without first giving the Company notice and ten days' opportunity to cure any occurrence constituting Good Reason.

"Severance Pay" under the Agreements consists of continuation of the Executive's salary, bonus and benefits for the unexpired employment term under the Agreements at the time of the termination (with a minimum annual bonus each year equal to that of the year before the termination), reasonable out-placement services and immediate vesting of all restricted stock and stock option rights. Severance Pay is not reduced by any post-termination employment or other income of the Executive. If the Executive dies while entitled to receive Severance

Pay, the remaining Severance Pay is to be paid to the Executive's estate. If a termination entitling the Executive to Severance Pay occurs after a Change in Control, or if the Company defaults on Severance Pay obligations, the monthly salary and bonus payments are accelerated and become payable immediately in a lump sum.

The Agreements prohibit the Executive from competing with the Company during his employment, and after his employment while he is receiving Severance Pay. The Executive may end the post-employment noncompetition period at any time by renouncing any right to further Severance Pay.

The Agreements provide for payment of the Executive's reasonable legal fees and expenses incurred in seeking to enforce the Executive's rights under the Agreements, to the extent the Executive is successful in his claims, with payment made contemporaneously but with the Executive required to repay any amount to which he is ultimately found not to be entitled. The Agreements also provide that the Company will make the Executive whole for any taxes, interest or penalties incurred by the Executive on account of the characterization of any payment to which the Executive is entitled from the Company as an "excess parachute payment" under Section 280G of the Code or any successor provision of the Code, so that the net payments to the Executive after all such taxes, interest and penalties will be the same as if no such characterization had occurred.

*Indemnity Agreements.* The Company has entered into indemnity agreements with each director and executive officer of the Company (collectively, "Leaders"). The indemnity agreements indemnify each Leader against all expenses incurred in connection with any action or investigation involving the Leader by reason of his or her position with the Company (or with another entity at the Company's request). The Leader will also be indemnified for costs, including judgments, fines and penalties, indemnifiable under Delaware law or under the terms of any current or future liability insurance policy maintained by the Company that covers the Leaders. A Leader involved in a derivative suit will be indemnified for expenses and amounts paid in settlement. Indemnification is dependent in every instance on the Leader meeting the standards of conduct set forth in the indemnity agreements. If a change in control or potential change in control occurs, the Company will fund a trust to satisfy its anticipated indemnification obligations.

*Stock Plan Provisions.* The Company's 1997 Stock Incentive Plan provides that, unless the Board or the Compensation Committee determines otherwise, upon a "change in control" of the Company as defined in that plan all outstanding stock option and other awards of stock and restricted stock shall become immediately exercisable and fully vested and nonforfeitable. In addition, upon a change in control of the Company, the Compensation Committee may, in its discretion, determine that some or all participants holding outstanding stock options shall receive cash in lieu of some or all of the stock subject to such options in an amount equal to the excess of the highest price per share actually paid in connection with the change in control of the Company over the exercise price per share under such options.

### Transactions with Directors and Officers

Directors and officers of the Company, businesses they own or represent, and members of their immediate families purchase services from the Company and its subsidiaries in the ordinary course of business. Rates and charges for these services are the same as those available to the general public.

In connection with the Cooperative's acquisition of TCIC and Iway, the Cooperative issued to the former shareholders of TCIC and Iway (collectively, the "Sellers") shares of Cooperative preferred stock which automatically upon consummation of the Merger were converted into 189,454 (as adjusted for the stock split) shares of Common Stock. In addition, the Sellers collectively received warrants that were converted into warrants to purchase an additional 77,912 (as adjusted for the stock split) shares of Common Stock. These warrants were exercised in full in January 1998. Jeffrey Parker, a director of the Company, was a shareholder of TCIC and Iway prior to the Cooperative's acquisition of TCIC and Iway. As a result of those acquisitions, Mr. Parker received shares of Cooperative preferred stock which were converted into 54,078 (as adjusted for the stock split) shares of Common Stock upon consummation of the Merger and warrants that were converted into warrants to purchase an additional 24,668 (as adjusted for the stock split) shares of Common Stock. Mr. Parker was also the holder of the Company's promissory note in the principal amount of $45,000, which note was paid in full in December 1997. In addition, Mr. Parker, as a former shareholder of TCIC and Iway, guaranteed a $330,000 loan by Norwest Bank to the Company that was made in connection with the acquisitions of TCIC and Iway. This loan was paid in full in December 1997.

**Independent Certified Public Accountants**

Olsen Thielen & Co., Ltd., certified public accountants, served as the Company's principal accountant for 1997. The Board of Directors of the Company has selected Olsen Thielen & Co., Ltd. to act as the Company's principal accountant for 1998. Representatives of Olsen Thielen & Co., Ltd. are not expected to be present at the Annual Meeting. If a representative of Olsen Thielen & Co., Ltd. attends the meeting, the representative will have an opportunity to make a statement and will be expected to be available to respond to appropriate questions.

**Proposals of Stockholders**

Proposals of stockholders intended to be presented at the 1999 annual meeting of stockholders must be received by the Company for consideration for inclusion in its proxy statement and form of proxy relating to that meeting by November 26, 1998. Proposals of stockholders should be made in accordance with Securities and Exchange Commission Rule 14a-8.

**Form 10-KSB Report Available**

**The Company's Form 10-KSB Annual Report to the Securities and Exchange Commission, including financial statements and financial statement schedules, will be provided without charge to stockholders upon written request. Requests should be directed to Mr. Craig A. Anderson, Chief Financial Officer, Dakota Telecommunications Group, Inc., Post Office Box 66, 29705 453rd Avenue, Irene, South Dakota 57037-0066.**

## TO OUR STOCKHOLDERS

This 1997 Annual Report to Stockholders contains our audited financial statements, detailed financial review and all of the information that regulations of the Securities and Exchange Commission (the "SEC") require to be presented in annual reports to stockholders. For legal purposes, this is the Dakota Telecommunications Group, Inc. 1997 annual report to stockholders. Although attached to our proxy statement, this report is not part of our proxy statement, is not considered to be soliciting material and is not considered to be filed with the SEC except to the extent that it is expressly incorporated by reference in a document filed with the SEC. Stockholders who would like to receive even more detailed information than that contained in this 1997 Annual Report to Stockholders are invited to request our Annual Report on Form 10-KSB.

**Our Annual Report on Form 10-KSB for the year ended December 31, 1997, including the financial statements and financial statement schedules, will be provided to any stockholder, without charge, upon written request to Mr. Craig Anderson, Executive Vice President and Chief Financial Officer, Dakota Telecommunications Group, Inc., P.O. Box 66, Irene, South Dakota 57037-0066.**

## LOOKING BACK AND LOOKING AHEAD

To Our Shareholders

---

As our Company faces a new year, we are getting ready for all the challenges that lie ahead. We are able to look forward with confidence because of what we were able to accomplish in 1997. When we look back upon 1997, we are justifiably proud of the incredible array of changes that we have lived through and accomplishments we have made. The individual accomplishments are substantial, and taken together evidence the construction of a broad, solid base for future growth and expansion. A brief review:

**Operations**

*We embarked upon a comprehensive overhaul of our entire network infrastructure and our operational and administrative facilities.*

1. We designed and built a powerful new multi-million-dollar switching center in the geographic center of our existing and planned service territories. Located in Viborg, South Dakota, this facility provides state-of-the-art telecommunications services for voice, video and data, with sufficient capacity to support over 100,000 customers.

2. We completed the most advanced fiber optic SONET network in the State of South Dakota, with interlocking OC-48 redundant and diversely routed rings supporting 2.4 Gigabits of capacity, with substantial growth capacity in reserve.

3. We became the first facilities-based, competitive local exchange company ("CLEC") in South Dakota, although considering the array and diversity of the services offered, we prefer to call ourselves an "Integrated Services Company" rather than just a CLEC.

4. We designed, constructed and began operating a hybrid fiber optic network that is the first of its kind in South Dakota and one of the first of its kind in the United States. This network provides a host of services, including video, voice and high speed data over an integrated system with fiber optic technology pushed far beyond mere transport, and deep into the network. This "one wire" solution is the wave of the future in integrated broadband services.

5. We completed our Sundowner site on 57th Street in Sioux Falls, South Dakota, establishing a fiber optic outpost on the edge of the City of Sioux Falls, and providing an additional platform and location for new and enhanced services within and surrounding the Sioux Falls metro area.

6. We expanded our internal construction capabilities by adding underground directional boring equipment and heavy construction equipment, including a state-of-the art plow train for the installation of underground cabling. We also added equipment and experienced personnel to install, maintain and troubleshoot fiber optic cabling and equipment. This improved both our capacity and our quality of work, and made it possible for us to reach new customers more quickly, and expand our network more economically.

7. We developed our own internal computer aided design mapping department, with software, systems and dedicated personnel to increase the efficiency and reliability of our network support and maintenance, as well as dramatically decrease our turnaround time on new projects.

8. We totally remodeled our offices in Irene and Sioux Falls, and added office space in Viborg, improving the ergonomics and the professional atmosphere for our employees, as well as adding needed space to accommodate our planned growth.

9. We laid the groundwork for comprehensive new personnel, salary and benefits systems that will enable us to continue to recruit and retain the best talent available.

10. Overall, we invested over $14 million to expand and modernize our network. Our net investment in capital improvements within South Dakota for 1997 tops that of most larger telecommunications companies in the state.

**Marketing**

*We developed our own internal marketing capabilities and put them to use immediately.*

1. We invented a Marketing Matrix analysis model that allows us to tailor our product offerings to specific geographic, demographic and economic markets. We also built our own internal market research and analysis capabilities, incorporating data from national, regional, state and local sources.

2. We designed and produced a comprehensive set of new Company letterhead, brochures and product literature. We also developed the ability to design and implement advertising and promotional campaigns.

3. We built an internal person-to-person sales force and tested the long distance small business market.

4. We started building detailed data bases to support our marketing efforts, including files for Company history, accomplishments, projects, services, capabilities, biographies and addresses.

**Acquisitions**

*We continued this Company's long tradition of expansion through the acquisition of successful high-performance companies.*

1. We merged with Iway Partners, Inc. of Sioux Falls. Iway is now a wholly-owned subsidiary of the Company known as DTG Internet Services, Inc. We are now about three times larger than the second biggest Internet services provider in South Dakota, and our technical support is second to none.

2. We merged with TCIC Communications, Inc., the well-known regional long distance and operator services company in Sioux Falls. TCIC is now a wholly-owned subsidiary of the Company known as DTG Communications, Inc. We now provide long distance services in a six-state area, and we furnish contracted operator services to 25 local exchange companies, a regional pay phone provider, the State of South Dakota and thousands of hotels, motels and other businesses.

3. We merged with Futuristic, Inc. dba DataNet of Sioux Falls. DataNet is now a wholly-owned subsidiary of the Company known as DTG DataNet, Inc. We are the largest local area network/wide area network integrator in South Dakota and the leading computer network design firm in this region. Started in 1981, DataNet now has 40 employees and 2,000 active customer accounts.

4. We signed an agreement to merge with Vantek Communications, Inc. and Van/Alert, Inc. ("Vantek") of Sioux Falls. Started in 1978, Vantek has grown into one of the area's leading mobile radio operator and the second largest paging business in South Dakota. Vantek's expertise will allow us to accelerate our Personal Communications Service build-out strategy. The completion of this merger is pending the approval of the wireless licenses by the Federal Communications Commission (expected by June 1998).

**Financial Structure**

*We revolutionized our entire financial structure in order to meet new threats, challenges and opportunities presented by profound changes in regulation, technology and consumer expectations.*

1. We believe we were the first telephone cooperative in America to convert to a public business corporation. Dakota's members and shareholders (who are our customers) approved the conversion by an overwhelming nine-to-one margin, giving us widespread support for our business plans. The conversion gives us potential access to the public equity markets.

2. We refinanced our entire outstanding Rural Utility Service debt, freeing us to develop competitive facilities. We also raised $14 million in additional long-term financing for new business developments, and have an established line of credit with the Rural Telephone Finance Corporation.

3. We reduced our dependence on (soon-to-be-seriously-shrinking) subsidized access revenues from 45% of gross revenues in 1996 to an estimated 16% in 1998.

4. We financed a $1 million Employee Stock Ownership Plan transaction. We also established an incentive stock option plan and a bonus pay plan for every single one of our employees and directors. (We rejected the idea, all-too-common in American business today, that such plans should be reserved only for the highest ranking and highest paid members of the organization.)

**Internal Systems**

*We thoroughly expanded and modernized our management information systems and reporting systems throughout the entire Company in order to better serve our rapidly growing customer base and to better enable us to build our business projections upon accurate, relevant data.*

1. We designed and implemented this Company's first comprehensive budgeting system, a new corporate forecasting model that enables us to manage the risks we want to take, and new management reports, including customer turnover reports, financial reports and financial statement formats. We also implemented a new cash disbursement system.

2. We selected and installed a new long distance billing system and a new Internet backroom platform and billing system.

3. We installed an entirely new accounting system, giving us the ability to report financial results for all of our companies on both a part 32 basis (needed for the National Exchange Carriers Association) and a Securities and Exchange Commission basis.

4. We researched and identified a new convergent billing system and a new customer support system and began incorporating both of them into our entire operation. Some of the modules of this system came on line in late 1997, and the rest are on schedule for early 1998.

In a single year, as a result of all these accomplishments, we have transformed this 96-year-old local business into a youthful growth company with over 160 employees, over 25,000 customers in six states, and over $25 million in annualized revenues. We believe that with these changes we can be competitive.

Where do we go from here? That depends on many things. Rapid transformation is difficult. Change is difficult. The telecommunications industry is being swept up in a wave of technological and regulatory changes that show no signs of abating. We cannot guarantee success, but we believe we have built a solid platform for future growth in a rapidly changing industry. We believe that our efforts in the past year have moved this Company from a static position in a previously monopolistic industry to a leading position as an integrated services provider in our chosen, regional markets. We believe that the best defense is a good offense, and we have created the kind of company that can adapt rapidly, move quickly and market successfully in a wide open game.

If the past is prologue, then 1998 should be an interesting year for us. While other companies keep talking about the future, we are building it -- together.

Sincerely,

T. W. Hertz

Tom Hertz
President and Chief Executive Officer

## DAKOTA TELECOMMUNICATIONS GROUP, INC.

Dakota Telecommunications Group, Inc. (the "Company") is a competitive local exchange carrier ("CLEC") specializing in the design, construction and operation of broadband telecommunications systems for small communities in South Dakota and the surrounding states. The Company currently operates 13 exchanges in southeastern South Dakota, four of which were built in 1997, incorporating over 2,240 miles of copper plant, 300 miles of coaxial cable and approximately 10,000 fiber miles of fiber optic lines. The Company also operates 13 additional cable television systems located in neighboring communities. The Company currently plans to systematically expand its backbone fiber network and continue to build new hybrid fiber facilities in new communities in the region.

The Company provides a full range of bundled telecommunications products and services to its customers, including switched local dial tone and enhanced services, network access services, long distance calling services, operator assisted calling services, telecommunications equipment sale and leasing services, cable television services, data networking services, Internet access and related services and local area network and wide area network ("LAN/WAN") services. No other single competitor currently offers all of these services in the Company's existing markets. The Company's customer base includes approximately 6,100 local service access lines, 5,500 cable television subscribers, 6,600 Internet users and over 2,000 LAN/WAN business customers located primarily in South Dakota, northwestern Iowa and southwestern Minnesota. The Company and its predecessors have been engaged in the telecommunications business since 1903.

The telecommunications industry is in a period of great change. Virtually every aspect of the industry is extremely competitive and subject to rapid technological innovation. The industry is also heavily regulated on both the federal and state level, and regulatory policies have changed dramatically in the past several years. The Company believes that these changes have opened several unique windows of opportunity, which serve as the focus of the Company's strategic growth plan. These opportunities include the deregulation of local service monopolies which now allows the Company to expand into new markets, the development of new hybrid fiber optic transmission technologies that provide a cost effective method for this expansion, and the Company's existing and targeted markets which, while growing, are located in small communities unlikely to immediately attract large competitors.

To address these opportunities, in 1996 the Company began a major reorganization and expansion program. This program included the redesign and rebuilding of the Company's switching center and telecommunications network, a project that was concluded in 1997, as well as the expansion of the Company's operations through selected acquisitions. During 1996, the Company purchased the assets of 19 cable television systems. In December 1996, the Company, through a wholly-owned subsidiary, merged with TCIC Communications, Inc. ("TCIC"), a South Dakota-based provider of long distance and operator services, now renamed DTG Communications, Inc. Also in December 1996, in a similar transaction, the Company merged with Iway Partners, Inc. ("Iway"), one of South Dakota's largest Internet service providers, now renamed DTG Internet Services, Inc. In December 1997, the Company merged with Futuristic, Inc. dba DataNet ("DataNet"), a leading regional LAN/WAN integrator located in Sioux Falls, South Dakota, now renamed DTG DataNet, Inc. All three companies continue to operate as wholly-owned subsidiaries of the Company. Also in December 1997, the Company signed a merger agreement with Vantek Communications, Inc. and Van/Alert, Inc. (collectively, "Vantek"), a regional specialized mobile radio ("SMR") and paging company in southeastern South Dakota. The Company currently anticipates that additional acquisitions will form a part of its continuing expansion plans, though no final agreements have been concluded at this time.

As part of its reorganization plans, the Company also changed its form of conducting business from a South Dakota cooperative into a public Delaware business corporation. On February 19, 1997, the Company filed a Registration Statement on Form S-4 (Registration Statement No. 333-22025) with respect to the proposed conversion of the Company from a cooperative into a South Dakota business corporation (the "Conversion") and the proposed merger of the resulting South Dakota business corporation into the Company, then a wholly-owned Delaware subsidiary of the cooperative (the "Merger"). At a special meeting of the members of the cooperative on July 21, 1997, the Conversion was approved. The Conversion was formalized on July 22, 1997 with the filing of the

Amended Articles of Incorporation approved by the members at the July 21, 1997 meeting. Immediately following the special meeting of the cooperative members, a special meeting of the shareholders of the resulting South Dakota business corporation was convened. At that meeting, the shareholders voted to approve an Agreement and Plan of Merger pursuant to which the South Dakota business corporation would be merged with and into the Company. The Merger became effective on July 25, 1997. As a result, the Company now operates as a public Delaware business corporation.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The following discussion is provided by management as its analysis of the Company's financial condition and results of operations. This analysis should be read in conjunction with the separate consolidated financial statements of the Company and the notes thereto included in this Annual Report.

### Forward-Looking Statements

This discussion and analysis of financial condition and results of operations, and other sections of this Annual Report, contain forward-looking statements that are based on management's beliefs, assumptions, current expectations, estimates and projections about the telecommunications industry, the economy, and about the Company itself, such as information relating to the Company's ongoing development plans, the effects of its July 1997 refinancing of its long-term debt, the impact of year 2000 issues on the Company's computerized operating systems and statements regarding the Company's anticipated future net losses. Words such as "anticipates," "believes," "estimates," "expects," "forecasts," "intends," "is likely," "plans," "predicts," "projects," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain known and unknown risks and uncertainties as well as assumptions ("Future Factors") that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Furthermore, the Company undertakes no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise.

Future Factors include, but are not limited to, uncertainties related to economic conditions, acquisitions and divestitures, government and regulatory policies, the pricing and availability of equipment, materials, inventories and software, technological developments and changes in the competitive environment in which the Company operates; changes in interest rates; demand for the Company's products and services; the degree of competition by traditional and non-traditional competitors; changes in tax laws; changes in prices, levies and assessments; and the outcomes of pending and future litigation and contingencies. These are representative of the Future Factors that could cause a difference between an ultimate actual outcome and a preceding forward-looking statement. Readers are cautioned not to place undue reliance on the forward-looking statements made below or elsewhere in this Annual Report.

### Overview

The Company is a competitive local exchange carrier specializing in the design, construction and operation of broadband telecommunications systems for small communities in South Dakota and the surrounding states. The Company provides a full range of bundled telecommunications products and services to its customers, including switched local dial tone and enhanced services, network access services, long distance telephone services, operator assisted calling services, telecommunications equipment sale and leasing services, cable television services, computer equipment sales, Internet access and related services and LAN and WAN services.

In 1996 the Company began a major reorganization and expansion program. This program included the conversion of the Company from a stock cooperative into a publicly held Delaware business corporation, the redesign and rebuilding of the Company's switching center and telecommunications network, which was completed in 1997, and the expansion of the Company's operations through selected acquisitions. During 1996, the Company purchased the assets of 19 cable television systems. In December 1996, the Company, through a wholly-owned subsidiary, merged with TCIC, a South Dakota-based provider of long distance and operator services. Also in December 1996, in a similar transaction, the Company merged with Iway, one of South Dakota's largest Internet service providers. In December 1997, the Company merged with DataNet, a leading regional LAN/WAN integrator located in Sioux Falls, South Dakota. These companies continue to operate as wholly-owned subsidiaries of the Company under the names DTG Communications, Inc., DTG Internet Services, Inc., and DTG DataNet, Inc., respectively. Also in December 1997, the Company signed a merger agreement with Vantek, a regional specialized mobile radio and paging company in southeastern South Dakota. The Company currently anticipates that this transaction will be completed prior to June 1998, pending Federal Communications Commission ("FCC") license transfer approvals. The Company currently anticipates that additional acquisitions will form a part of its continuing expansion plans, though no final agreements have been concluded at this time.

The Company's reorganization and expansion plans have had, and will continue to have, significant impacts on the Company's financial condition and results of operations. As part of its network rebuilding project, in 1995 the Company reassessed the remaining useful life of its old facilities. In 1996 and 1997, the Company incurred approximately $5.8 million and $13.6 million in new capital expenditures, respectively. The Company anticipates spending substantial additional funds for its continuing development programs. These expenditures have been, and future expenditures are anticipated to be, financed through substantial increases in the Company's long-term debt. These changes will combine to result in substantially higher depreciation and interest expenses with a corresponding reduction in the Company's net income. In addition, to implement its growth plans, the Company completed the acquisitions described above and increased its employee base from 34 employees at December 31, 1995, to 76 employees at December 31, 1996, and to 161 employees at December 31, 1997, resulting in additional increases in amortization expense and employee-related operating expenses. While the Company anticipates that its revenue base will continue to grow as it completes its new facilities and markets new services, the resultant higher expense levels from a combination of higher depreciation, amortization and interest expense, as well as additional employee expenses, will likely cause the Company to recognize and report net after-tax losses.

**Financial Condition, Liquidity and Capital Resources**

| (Dollars in Thousands) | For the Year Ended December 31, 1997 | 1996 |
|---|---|---|
| Selected Balance Sheet Items | | |
| Cash and Temporary Cash Investments | $ 4,597.9 | $ 2,870.4 |
| Accounts Receivable, Net | 4,216.0 | 1,784.9 |
| Materials and Supplies | 1,109.2 | 694.1 |
| Excess of Cost Over Net Assets Acquired | 4,869.1 | 1,831.0 |
| Other Investments | 2,037.6 | 625.7 |
| Property, Plant and Equipment, Net | 25,408.3 | 14,441.1 |
| Current Liabilities | 6,921.8 | 1,594.8 |
| Selected Cash Flow Items | | |
| Capital Expenditures | $ 13,564.0 | $ 5,751.6 |
| Cash Provided From Operations | 1,851.7 | 1,961.8 |
| Cash Used for Investment | 15,608.2 | 7,516.2 |
| Cash Provided From Financing | 15,933.0 | 1,353.0 |
| Selected Capital Structure Items | | |
| Long-Term Debt | $ 29,200.5 | $ 15,338.4 |
| Total Capital | 38,394.5 | 22,448.3 |
| Long-Term Debt to Total Capital | 76% | 68% |

## Analysis of Material Changes in Balance Sheet Items

Cash and Temporary Cash Investments increased from $2,870,400 at December 31, 1996, to $4,597,900 at December 31, 1997, an increase of $1,727,500. Approximately $200,000 of this increase was attributable to the DataNet operation acquired by the Company in December 1997. The balance represents long-term debt borrowings by the Company in late December 1997 in anticipation of the repayment of the Company's $1,500,000 short-term revolving loan from the Rural Telephone Finance Cooperative ("RTFC") in early January 1998. See Note 4 to the Consolidated Financial Statements.

Net Accounts Receivable increased from $1,784,900 at December 31, 1996, to $4,216,000 at December 31, 1997, an increase of $2,431,100. Of this increase, $1,779,600 was attributable to net receivables from the DataNet operation acquired in December 1997. The balance of this increase is primarily related to additional funds due to the Company from final adjustments to its access revenue requirements from its 1996 and 1997 telephone operation cost studies. See Note 1(M) to the Consolidated Financial Statements.

Materials and Supplies inventories increased from $694,100 at December 31, 1996, to $1,109,200 at December 31, 1997, an increase of $415,100. Of this increase, $187,000 was related to the inventories of goods held for resale in the Company's DataNet operation. The balance represents materials on hand to be used in the Company's planned 1998 development projects.

Excess of Cost Over Net Assets Acquired increased from $1,831,000 at December 31, 1996, to $4,869,100 at December 31, 1997, an increase of $3,038,100. This increase is due to the Company's acquisition of DataNet in December 1997, which was accounted for using the purchase method. See Note 13 to the Consolidated Financial Statements.

Other Investments increased from $625,700 at December 31, 1996, to $2,037,600 at December 31, 1997, an increase of $1,411,900. This increase was primarily due to the purchase by the Company of RTFC subordinated capital certificates in connection with the long-term financing agreement reached with the RTFC in July 1997. These certificates bear no interest and will be refunded to the Company upon retirement of the associated debt. See the discussion of the RTFC financing agreement, below, and Note 6 to the Consolidated Financial Statements. The Company anticipates making further investments in RTFC capital certificates as it continues to borrow additional long-term funds from the RTFC.

Net fixed assets increased from $14,441,100 at December 31, 1996, to $25,408,300 at December 31, 1997, a net increase of $10,967,200. This increase primarily represents additional telecommunications plant assets constructed by the Company in 1997. See Note 3 to the Consolidated Financial Statements. The Company currently plans to make substantial additional investments in new telecommunications facilities and accordingly expects net fixed assets to significantly increase in future years as these facilities are constructed.

Current Liabilities increased from $1,594,800 at December 31, 1996, to $6,921,800 at December 31, 1997, an increase of $5,327,000. Approximately $1,500,000 of this increase was attributable to normal current liabilities associated with the DataNet operation acquired by the Company in December 1997. These liabilities included approximately $569,300 in floor plan financing arrangements. See Note 5 to the Consolidated Financial Statements. An additional $1,500,000 of the increase represents amounts due under the Company's short-term revolving loan arrangement with the RTFC, which was repaid in full in early January 1998. See Note 4 to the Consolidated Financial Statements. The current portion of the Company's long-term debt increased $692,300 due to the overall increase in the Company's total long-term debt. The remaining increase related primarily to current amounts due suppliers and contractors in connection with the Company's 1997 development projects.

Long-Term Debt increased from $15,338,400 at December 31, 1996, to $29,200,500 at December 31, 1997. At December 31, 1997, this debt consisted of approximately $29,600,000 under a series of loans from the RTFC and $1,000,000 in long-term financing from Home Federal Savings Bank associated with the guarantee by the Company of long-term debt incurred by the Company's Employee Stock Ownership Plan to fund the acquisition of Company stock in December 1997, net of $1,390,000 in associated current maturities. See Note 6 to the Consolidated Financial Statements. On June 24, 1997, the Company entered into a long-term loan arrangement with the RTFC in the aggregate amount of $28,421,000. Of this amount, $13,092,089 was used to refinance the then outstanding long-term debt from the Rural Utilities Service on July 15, 1997. The remaining amounts are allocated to refinance the $1,000,000 in debt assumed by the Company in the TCIC and Iway acquisitions and to cover the Company's 1997 capital expenditures program. Substantially all of the Company's 1997 capital expenditures were financed by the RTFC.

Total Stockholders' Equity increased from $6,412,200 at December 31, 1996, to $7,804,100 at December 31, 1997, an increase of approximately $1,400,000. This increase was primarily caused by the issuance of stock in connection with the DataNet merger, reduced by the Company's 1997 operating loss. The presentation of the Stockholders' Equity account structure changed substantially during 1997 due to the conversion of the Company from a South Dakota stock cooperative into a Delaware business corporation in July 1997. The primary change was the reclassification of the capital accounts from preferred stock and cooperative capital credits into common stock. The Conversion, by itself, did not change overall total equity. The Conversion process is discussed in more detail above and in Notes 2, 7 and 15 to the Consolidated Financial Statements.

**Liquidity and Capital Resources**

The Company believes that it has adequate internal resources available to finance its ongoing operating requirements. Net Cash Provided From Operations was $1,851,700 in 1997, down slightly from $1,961,800 in 1996. See the Consolidated Statement of Cash Flows included in the Company's Consolidated Financial Statements. This decrease was attributable primarily to additional employee costs in 1997. In addition, the Company maintains a $1,500,000 revolving line of credit with the RTFC, all of which was available as of March 1, 1998. The Company has also arranged an additional $4,000,000 secured line of credit from the RTFC in March 1998. Finally, the Company uses a combination of the floor plan financing arrangements described above and an $800,000 working capital line of credit to fund inventory holding costs in its DataNet operation. At March 1, 1998, there were no amounts drawn under this line of credit.

While the Company can finance its day-to-day operations using internal funds, it will need additional long-term financing to complete additional network construction programs. The Company's primary long-term lender is the RTFC which, as described above, refinanced the Company's outstanding long-term debt in July 1997 and provided additional funds for the Company's 1997 construction projects. While there is no assurance that additional funds will be made available to the Company, the Company and its subsidiaries expect the RTFC and other sources to continue to be available for future borrowings.

**Results of Operations**

| **(Dollars in Thousands)** | For the Year Ended December 31, | |
|---|---|---|
| | 1997 | 1996 |
| Summary of Consolidated Operations | | |
| Total Operating Revenues | $ 13,729.0 | $ 8,101.3 |
| Depreciation and Amortization | 3,448.1 | 2,434.4 |
| Other Costs and Expenses | 12,039.6 | 5,589.1 |
| Operating Income (Loss) | (1,758.7) | 77.9 |
| Other Income (Expense) | (846.6) | (413.8) |
| Income Tax Expense (Benefit) | (118.5) | (175.7) |
| Net Loss | $ (2,486.8) | $ (160.2) |

In 1997, revenues increased substantially to $13,729,000, up from $8,101,300 in 1996, an increase of $5,627,700 or 69.5%. Of this increase, $1,481,000, $1,021,000, and $1,788,100 was attributable to revenues from the Company's TCIC, Iway and DataNet operations, respectively. The balance of the increase represents primarily revenues from access rate increases put into effect by the Company during 1996.

Depreciation and Amortization expense increased from $2,434,400 in 1996 to $3,448,100 in 1997, an increase of approximately $1,000,000 or 41%. Approximately $133,300 of this increase is attributable to the amortization of the excess of cost over the net assets acquired in the merger transactions with TCIC and Iway in December 1996 and with DataNet in December 1997. The balance represents additional depreciation for assets placed in service during 1997.

Other Costs and Expenses increased to $12,039,600 in 1997, up from $5,589,100 in 1996, an increase of $6,450,500 or 115%. Of this increase, $1,214,100, $2,170,100, and $1,732,700 represent additional costs and expenses associated with the Iway, TCIC and DataNet operations, respectively. An additional $611,342 of this increase represents one-time, nonrecurring charges associated with the Conversion and Merger in July 1997. These reorganization expenses do not arise from and are not representative of the Company's ongoing business. See Note 2 to the Consolidated Financial Statements. The balance of the increase is primarily due to increased employee costs in the Company's telephone and cable operations.

Other Income and Expense consists primarily of interest and dividend income and interest expense. Interest expense in 1997 was $1,122,807 (total interest expense of 1,294,607 net of $171,800 that was capitalized as construction period interest related to the Company's 1997 developments) compared to $723,778 in 1996, an increase of $399,029 or 55%. The increase in interest expense was caused primarily by increased long-term borrowings used by the Company to finance its 1997 construction projects.

On a pro forma basis, assuming that all shares issuable in the reorganization were outstanding for all of 1997, and assuming all capital stock and capital credits were converted into shares of Common Stock at a rate of $2.50 per share at the beginning of 1996, loss per share would have been $1.19 for 1997 and $.09 for 1996. Also on a pro forma basis, assuming that only those shares that were actually issued and outstanding as of March 16, 1998 had been outstanding for all of 1997, loss per share for 1997 would have been $1.30.

**Results of Business Segment Operations**

The Company currently operates with three major business segments: telephone operations, which includes all operations other than cable television and computer networking operations; cable television operations; and the computer networking services acquired by the Company in the DataNet transaction in December 1997. Because of the technological convergence of computer services, telephone and cable systems which allow these services to be offered through a single network, the Company believes that business segment reporting will not be appropriate in future years.

The following sections discuss the operating results for these three segments in 1997 and 1996.

**Telephone Operations**

| (Dollars in Thousands) | For the Year Ended December 31, 1997 | 1996 |
|---|---|---|
| Local Service | $ 1,221.8 | $ 1,058.7 |
| Long Distance Toll Service | 3,478.7 | 1,996.3 |
| Access Service | 4,176.7 | 3,267.0 |
| Internet Services | 1,021.3 | 72.4 |
| Other Revenues | 149.8 | 357.8 |
| Total Revenue | $ 10,048.3 | $ 6,752.2 |
| Depreciation and Amortization | 2,728.0 | 2,011.0 |
| Other Costs and Expenses | 8,703.6 | 4,287.1 |
| Operating Income (Loss) | $(1,383.3) | $ 454.1 |

Local service revenues are earned by providing customers with local service to connecting points within the local exchange boundaries and, in certain cases, to nearby local exchanges under extended area service ("EAS") plans that eliminate long distance charges to the neighboring exchanges. Local service revenues for 1997 were $1,221,800 compared to $1,058,700 in 1996, an increase of 15%. This increase was due primarily to a local service rate increase approved by the Board of Directors in December 1995 and implemented in February and July 1996. There are no local rate requests currently pending for the Company nor does the Company currently anticipate any local rate increases during 1998. The Company's local service rates are not currently regulated by the FCC or the South Dakota Public Utilities Commission, although certain regulatory policies of both agencies indirectly impact local rate levels.

Long distance toll revenues rose from $1,996,300 in 1996 to $3,478,700 in 1997, an increase of $1,482,400 or 74%. This increase was primarily due to long distance revenues from the TCIC long distance reselling operation acquired by the Company in December 1996.

Access revenues are received by local exchange companies ("LECs") for intrastate and interstate exchange services provided to long distance carriers (generally referred to as interexchange carriers or "IXCs") which enable IXCs to provide long distance service to end users in the local exchange network. Access revenues are determined, in the case of interstate calls, according to rules issued by the FCC and administered by the National Exchange Carrier Association ("NECA") and, in the case of intrastate calls, by state regulatory agencies. A relatively small portion of the Company's access revenues are derived from subscriber line fees determined by the FCC and billed directly to end users for access to long distance carriers. The balance of the Company's interstate access revenues are received from NECA, which collects payments from IXCs and distributes settlement payments to LECs based on a number of factors, including the cost of providing service and the amount of time the local network is utilized to provide long distance services. A variety of factors, including increased subscriber counts, cultural and technological changes and rate reductions by IXCs, have resulted in a consistent pattern of increasing use of the nation's telephone network since 1984. This growth has produced higher revenues for NECA and increased settlements for its participating LECs. Access revenues increased from $3,267,000 in 1996 to $4,176,700 in 1997, an increase of $909,700 or 27.8%. The Company reassesses its access rates and underlying cost studies annually and adjusts its tariff rate filings and participation in NECA and Universal Service Fund revenue pools accordingly. In late 1996, the Company received approval from the South Dakota Public Utilities Commission to increase its intrastate access rates approximately 20%, which increase, combined with increased settlements from the NECA pool, primarily accounts for the overall increase in access revenue in 1997.

Internet service revenue rose from $72,447 in 1996 to $1,021,344 in 1997, an increase of $951,897 or 1,314% due to the inclusion of revenues from the Iway Internet operations acquired in December 1996 and internal growth in revenues from the Company's Internet operations.

Other revenue decreased from $357,800 in 1996 to $149,800 in 1997, a decrease of $208,000 or 58%. Most of this decrease is due to the transfer of the Company's unregulated customer premises equipment business from its Telephone Operations segment to its Cable Television Operations segment in January 1997.

Depreciation and amortization expenses rose from $2,011,000 in 1996 to $2,728,000 in 1997, an increase of $717,000 or 36% as a result of the Company's additional capital expenditures for the year and the amortization of costs associated with its acquisitions of TCIC and Iway. See Note 13 to the Consolidated Financial Statements.

Other costs and expenses were $8,703,600 in 1997 compared to $4,287,100 in 1996, an increase of $4,416,500 or 103%. Of this increase, $1,214,100 and $2,170,100 represent additional costs and expenses associated with the Internet and long distance operations acquired in December 1996. An additional $611,342 of this increase represents one-time, nonrecurring charges associated with the Conversion and Merger in July 1997. These reorganization expenses do not arise from and are not representative of the Company's ongoing business. See Note 2 to the Consolidated Financial Statements. The balance of the increase is primarily due to increased employee expense.

**Cable Television Operations**

| (Dollars in Thousands) | For the Year Ended December 31, 1997 | 1996 |
|---|---|---|
| Cable Service Revenue | $ 1,517.0 | $ 1,300.5 |
| Other Revenue | 375.6 | 48.7 |
| Total Revenue | 1,892.6 | 1,349.2 |
| Depreciation and Amortization | 702.8 | 423.4 |
| Other Costs and Expenses | 1,620.5 | 1,302.0 |
| Operating Income (Loss) | $ (430.7) | $ (376.2) |

The Company's cable service revenues increased from $1,300,500 in 1996 to $1,517,000 in 1997, an increase of $216,500 or 17%. This increase primarily reflects additional revenues for the entire year of 1997 from the 19 cable systems purchased by the Company during 1996.

Other revenue increased from $48,700 in 1996 to $375,600 in 1997, an increase of $326,900 or 6,713%. This increase was due to the transfer of the Company's unregulated customer premises equipment business from its Telephone Operations segment to its Cable Television Operations segment in January 1997.

Depreciation and amortization expenses were $702,800 in 1997 compared to $423,400 in 1996, an increase of $279,400 or 66%. This increase was primarily due to the depreciation of additional assets used to operate the 19 cable systems added by the Company in 1996 for the entire year of 1997.

Other costs and expenses were $1,620,500 in 1997 compared to $1,302,000 in 1996, an increase of $318,500 or 24%. This increase primarily reflects additional expenses for the entire year of 1997 from the operation of the 19 cable systems purchased by the Company during 1996.

**Computer Networking Operations**

| (Dollars in Thousands) | For the Year Ended December 31, 1997 | 1996 |
|---|---|---|
| Computer Network Sales Revenue | $ 1,778.1 | $ --- |
| Other Costs and Expenses | 1,722.7 | --- |
| Operating Income | $ 55.4 | $ --- |

The Computer Networking Operations segment operating results reflect the operations of the Company's DataNet subsidiary for the month of December 1997. The Company acquired DataNet on December 1, 1997. See Note 13 to the Consolidated Financial Statements.

## Income Taxes

The Company historically operated as a stock cooperative and was granted tax-exempt status under Section 501(c)(12) of the Internal Revenue Code of 1986, as amended. Accordingly, income tax expense was related only to certain ancillary operations, such as the Company's cable television operations. Beginning with the Company's conversion from a cooperative to a Delaware business corporation in July 1997, all of the Company's operations became taxable. However, because of the Company's consolidated net losses, the Company has accumulated significant income tax loss carryovers. See Note 11 to the Consolidated Financial Statements for a full discussion of the Company's income tax issues.

## Effects of Inflation

The Company is subject to the effects of inflation upon its operating costs. The Company's local exchange telephone companies are subject to the jurisdiction of the South Dakota Public Utilities Commission with respect to a variety of matters, including rates for intrastate access services and the conditions and quality of service. Rates for local telephone service are not established directly by regulatory authorities, but their authority over other matters limits the Company's ability to implement rate increases. In addition, the regulatory process inherently restricts the Company's ability to immediately pass cost increases along to customers unless the cost increases are anticipated and the rate increases are implemented prospectively.

All of the Company's long-term debt from the RTFC bears interest on a floating rate set by the RTFC on a monthly basis. This variable rate was 6.65% at December 31, 1997. The Company has the option to fix the interest rate on all or a portion of these loans on a quarterly basis. Should inflation rates significantly exceed the Company's expectations, interest rates could increase and the Company's debt service expenses could increase beyond acceptable limits or make the RTFC or any other lender unwilling to extend additional credit to the Company.

## Competition

In February 1996, President Clinton signed into law the Telecommunications Act of 1996 (the "1996 Act"). The new law represents the biggest change in the rules governing local telephone service since Congress imposed federal regulation and established the FCC in 1934. Under the 1996 Act, the monopoly on local service enjoyed by local exchange companies ("LECs") is eliminated and LECs must allow competitors access to their local network facilities. The Company does not know to what extent it will be subject to local competition in the markets it serves under the new rules. The final results of the changes made by the new law will not be known until new rulemaking by the FCC and state regulatory agencies has been completed. The Company is monitoring developments regarding the new regulatory climate closely and expects its operations may be materially affected by the new rules, but the Company cannot predict what effect the new rules will have on its business.

The Company is presently the only provider of local telephone service in its historical nine local service exchanges and directly competes with the incumbent local service company in the four exchanges it built in 1997. Technological developments in competing technologies, such as cellular telephone, digital microwave, coaxial cable, fiber optics and other wireless and wired technologies, may result in new forms of competition to the Company's landline services. The Company and many other members of the local exchange carrier industry are seeking to maintain a strong, universally affordable public telecommunications network through policies and programs that are sensitive to the needs of small communities and rural areas served by the Company. There is no assurance that the Company will be able to continue to do so in the future.

All of the Company's cable television franchises are non-exclusive. In addition to competition from off-air television, other technologies also supply services provided by cable television. These include low power television stations, multi-point distribution systems, over-the-air subscription television and direct broadcast satellites. The Company believes that cable television presently offers a wider variety of programming at lower cost than any competing technology. However, the Company is unable to predict the effect current or developing sources of competition may have on its cable business.

The Company's unregulated Internet, long distance, operator services and computer network services businesses are subject to intense competition from many different companies, many of which have substantially greater resources than the Company.

**Year 2000 Computer Software Issues**

The Company is highly dependent upon advanced computer systems and specialized software for the conduct of its business. These systems include switching and network operations, billing and customer care, accounting and reporting and Internet operating systems, as well as a wide assortment of personal computer productivity software. In 1997, as part of its reorganization plan, the Company installed new accounting and reporting systems and began the installation of a new billing and customer service system, currently scheduled for completion in 1998. The Company also rebuilt its Internet operating systems and installed a new switching platform and software system in 1997.

As part of its systems replacement process, the Company addressed an issue that is facing all users of automated information systems. The issue is that many computer systems that process date sensitive information based on two digits representing the year of the event may recognize a date using "00" as the year 1900 rather than the year 2000. The inability to correctly recognize "00" as the year 2000 could affect a wide variety of automated information systems, such as mainframe applications, invoicing and receivables tracking systems, event scheduling systems, personal computers and communication systems, in the form of software failure, errors or miscalculations.

The Company's software suppliers have assured the Company that its new systems will not experience year 2000 problems. However, given the complexity of the specialized software used by the Company and the relative newness of the year 2000 problem, there can be no assurance that the Company's new or remaining systems will not experience some problems as these systems begin to operate using year 2000 dates. While the Company will continue to monitor and test its systems for potential problems, failure of key software systems to properly recognize and handle year 2000 dates could result in material and wide-spread failures in the Company's operations, possibly leading to severe service outages and customer complaints. Such failures, were they to occur, would have severe adverse effects on the Company's results of operations, liquidity and capital resources.

**Recently Issued Accounting Pronouncements**

In June 1997, the Financing Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standard No. 131, "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). This pronouncement, effective for calendar year 1998 financial statements, requires reporting segment information consistent with the way executive management of an entity disaggregates its operations internally to assess performance and make decisions regarding resource allocations. Among information to be disclosed, SFAS 131 requires an entity to report a measure of segment profit or loss, certain specific revenue and expense items and segment assets. SFAS 131 also requires reconciliations of total segment revenues, total segment profit or loss and total segment assets to the corresponding amounts shown in the entity's consolidated financial statements. The Company expects that the adoption of SFAS 131 will reduce the number or designation of reportable segments currently disclosed in its consolidated financial statements due to the increasing convergence of its computer, telephone and cable television businesses.

No other recently issued accounting pronouncements are expected to have a significant effect on future financial statements.

**Environmental Matters**

Management is not currently aware of any environmental matters which in the aggregate would have a material adverse effect on the financial condition or results of operations of the Company.

## INDEPENDENT AUDITORS' REPORT

Board of Directors
Dakota Telecommunications Group, Inc.
and Subsidiaries
Irene, South Dakota

We have audited the accompanying consolidated balance sheet of Dakota Telecommunications Group, Inc. (incorporated in Delaware and formerly Dakota Cooperative Telecommunications, Inc.) and subsidiaries as of December 31, 1997, and 1996, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Dakota Telecommunications Group, Inc. and subsidiaries as of December 31, 1997, and 1996, and the results of their operations and their cash flows for the years then ended, in conformity with generally accepted accounting principles.

St. Paul, Minnesota
January 30, 1998

Olsen Thielen & Co., Ltd.

## CONSOLIDATED FINANCIAL STATEMENTS

## DAKOTA TELECOMMUNICATIONS GROUP, INC. AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEET
### DECEMBER 31, 1997 AND 1996

| ASSETS | 1997 | 1996 |
|---|---|---|
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | $ 4,297,938 | $ 2,121,444 |
| Temporary Cash Investments | 300,000 | 749,000 |
| Accounts Receivable, Less Allowance for Uncollectibles of $298,700 and $152,300 | 4,216,025 | 1,784,895 |
| Deposits | - | 274,889 |
| Income Taxes Receivable | 62,987 | 248,500 |
| Materials and Supplies | 1,109,226 | 694,097 |
| Prepaid Expenses | 275,567 | 168,078 |
| Total Current Assets | 10,261,743 | 6,040,903 |
| INVESTMENTS AND OTHER ASSETS: | | |
| Excess of Cost Over Net Assets Acquired | 4,869,096 | 1,830,959 |
| Other Intangible Assets | 809,843 | 509,559 |
| Other Investments | 2,037,571 | 625,722 |
| Deferred Charges | 653,373 | 56,628 |
| Total Investments and Other Assets | 8,369,883 | 3,022,868 |
| PROPERTY, PLANT AND EQUIPMENT, NET | 25,408,266 | 14,441,104 |
| TOTAL ASSETS | $ 44,039,892 | $ 23,504,875 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| CURRENT LIABILITIES: | | |
| Current Portion of Long-Term Debt | $ 1,390,000 | $ 697,700 |
| Note Payable | 1,500,000 | - |
| Accounts Payable | 2,290,727 | 399,694 |
| Payable Under Floor Plan Arrangements | 569,287 | - |
| Other Current Liabilities | 1,171,772 | 497,388 |
| Total Current Liabilities | 6,921,786 | 1,594,782 |
| LONG-TERM DEBT | 29,200,469 | 15,338,395 |
| DEFERRED CREDITS | 113,565 | 159,482 |
| STOCKHOLDERS' EQUITY: | | |
| Preferred Stock | - | 1,172,000 |
| Common Stock | 8,523,870 | 26,185 |
| Treasury Stock at Cost | (12,325) | - |
| Capital Credits | - | 4,732,723 |
| Other Capital | 2,298,006 | - |
| Retained Earnings (Deficit) | (2,005,479) | 481,308 |
| Unearned Employee Stock Ownership Plan Shares | (1,000,000) | - |
| Total Stockholders' Equity | 7,804,072 | 6,412,216 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | $ 44,039,892 | $ 23,504,875 |

The accompanying notes are an integral part of the consolidated financial statements.

## DAKOTA TELECOMMUNICATIONS GROUP, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF OPERATIONS
### YEARS ENDED DECEMBER 31, 1997 AND 1996

| | 1997 | 1996 |
|---|---|---|
| REVENUES: | | |
| Local Network | $ 1,221,788 | $ 1,058,667 |
| Network Access | 4,176,695 | 3,266,969 |
| Long Distance Network | 3,478,721 | 1,996,301 |
| Cable Television Service | 1,517,028 | 1,300,512 |
| Computer Network Sales | 1,788,104 | - |
| Internet Service | 1,021,344 | 72,447 |
| Other | 525,312 | 406,446 |
| Total Operating Revenues | 13,728,992 | 8,101,342 |
| COSTS AND EXPENSES: | | |
| Plant Operations | 4,082,624 | 2,406,766 |
| Cost of Goods Sold | 1,465,885 | - |
| Depreciation and Amortization | 3,448,109 | 2,434,416 |
| Customer | 1,465,735 | 500,802 |
| General and Administrative | 4,215,257 | 1,817,869 |
| Other Operating Expenses | 810,041 | 863,639 |
| Total Operating Expenses | 15,487,651 | 8,023,492 |
| OPERATING INCOME (LOSS) | (1,758,659) | 77,850 |
| OTHER INCOME AND (EXPENSES): | | |
| Interest and Dividend Income | 276,204 | 309,982 |
| Interest Expense | (1,122,807) | (723,778) |
| Net Other Income and (Expenses) | (846,603) | (413,796) |
| LOSS BEFORE INCOME TAXES | (2,605,262) | (335,946) |
| INCOME TAX BENEFIT | (118,475) | (175,712) |
| NET LOSS | $ (2,486,787) | $ (160,234) |
| BASIC AND DILUTED LOSS PER SHARE (since reorganization) | $ (1.35) | |

The accompanying notes are an integral part of the consolidated financial statements.

## DAKOTA TELECOMMUNICATIONS GROUP, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY YEARS ENDED DECEMBER 31, 1997 AND 1996

| | Preferred Stock | Common Stock | Treasury Stock | Capital Credits | Other Capital | Retained Earnings (Deficit) | Unearned Employee Stock Ownership Plan Shares | Total |
|---|---|---|---|---|---|---|---|---|
| BALANCE on December 31, 1995 | $ | $ 26,125 | $ | $ 4,643,909 | $ | $ 745,271 | $ | $ 5,415,305 |
| Net Income (Loss) | | | | 103,729 | | (263,963) | | (160,234) |
| Common Stock Issued, Net | | 60 | | | | | | 60 |
| Preferred Stock Issued (1,172 Shares) | 1,172,000 | | | | | | | 1,172,000 |
| Retirement of Capital Credits to Estates | | | | (14,915) | | | | (14,915) |
| BALANCE on December 31, 1996 | 1,172,000 | 26,185 | - | 4,732,723 | - | 481,308 | - | 6,412,216 |
| Net Loss | | | | | | (2,486,787) | | (2,486,787) |
| Issuance of Common Stock in Exchange for Preferred Stock, Capital Credits and Capital Stock | (1,172,000) | 3,471,770 | | (4,597,776) | 2,298,006 | | | - |
| Retirement of Capital Credits | | | | (134,947) | | | | (134,947) |
| Common Stock Issued, Net | | 4,025,915 | (12,325) | | | | | 4,013,590 |
| Employee Stock Ownership Plan Shares Purchased | | 1,000,000 | | | | | (1,000,000) | - |
| BALANCE on December 31, 1997 | $ - | $ 8,523,870 | $ (12,325) | $ - | $ 2,298,006 | $ (2,005,479) | $ (1,000,000) | $ 7,804,072 |

The accompanying notes are an integral part of the consolidated financial statements.

## DAKOTA TELECOMMUNICATIONS GROUP, INC. AND SUBSIDIARIES

### CONSOLIDATED STATEMENT OF CASH FLOWS
### YEARS ENDED DECEMBER 31, 1997 AND 1996

| | 1997 | 1996 |
|---|---|---|
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net Loss | $ (2,486,787) | $ (160,234) |
| Adjustments to Reconcile Net Loss to Net Cash Provided By Operating Activities: | | |
| Depreciation and Amortization | 3,448,109 | 2,469,873 |
| Deferred Charges | 67,060 | 208,248 |
| Deposits | 274,889 | 274,889 |
| Receivables | (1,296,894) | (155,521) |
| Income Taxes Receivable | 185,513 | (248,500) |
| Prepaid Expenses | (101,777) | (52,618) |
| Accounts Payable | 1,464,361 | (379,143) |
| Accrued Income Taxes | - | (260,655) |
| Other Current Liabilities | 370,819 | 206,778 |
| Deferred Credits | (73,589) | 58,719 |
| Net Cash Provided By Operating Activities | 1,851,704 | 1,961,836 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of Property, Plant and Equipment | (13,564,024) | (5,751,604) |
| Deposits | - | 107,822 |
| Sale of Temporary Cash Investments | 649,000 | - |
| Purchase of Temporary Cash Investments | (200,000) | (749,000) |
| Purchase of Other Investments | (1,473,754) | (532,977) |
| Purchase of Other Intangible Assets | (279,832) | (541,300) |
| Deferred Charges | (663,805) | (8,885) |
| Acquisition Costs, Net of Cash Acquired | (75,812) | (40,295) |
| Net Cash Used In Investing Activities | (15,608,227) | (7,516,239) |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Proceeds from Issuance of Long-Term Debt | 33,912,727 | 4,399,270 |
| Principal Payments of Long-Term Debt | (20,241,444) | (2,844,967) |
| Proceeds from Issuance of Note Payable | 1,500,000 | - |
| Construction Contracts Payable | (116,909) | (182,912) |
| Retirement of Capital Credits | (134,947) | (14,915) |
| Other | - | (3,513) |
| Issuance of Common Stock | 1,025,915 | - |
| Purchase of Treasury Stock | (12,325) | - |
| Net Cash Provided by Financing Activities | 15,933,017 | 1,352,963 |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 2,176,494 | (4,201,440) |
| CASH AND CASH EQUIVALENTS at Beginning of Year | 2,121,444 | 6,322,884 |
| CASH AND CASH EQUIVALENTS at End of Year | $ 4,297,938 | $ 2,121,444 |

The accompanying notes are an integral part of the consolidated financial statements.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Nature of Operations - The Company is a diversified telecommunications services company, which, directly or through wholly-owned subsidiaries, provides wireline local and network access sales, long-distance telephone services, operator assisted calling services, telecommunications and computer equipment sale and leasing services, cable television services, Internet access, computer network services and related services. The principal market for these telecommunications and cable services are local residential and business customers residing in southeastern South Dakota, with a portion of its cable television customers in northwestern Iowa and southwestern Minnesota. No single customer accounted for a significant amount of revenues and accounts receivable.

Local service rates charged to telephone customers are established by the Company and are not subject to regulation. Toll and access rates are subject to state and Federal Communications Commission regulation. Rates charged cable television customers are established by the Company.

B. Principles of Consolidation - The consolidated financial statements include the accounts of Dakota Telecommunications Group, Inc. (formerly Dakota Cooperative Telecommunications, Inc.) and its wholly owned subsidiaries, Dakota Telecom, Inc., DTG Internet Services, Inc. (formerly IWAY, Inc.), DTG Communications, Inc. (formerly TCIC Communications, Inc.), Dakota Telecommunications Systems, Inc. (and its wholly-owned subsidiary, Dakota Wireless Systems, Inc.), DTG DataNet, Inc. (formerly Futuristic, Inc. d/b/a DataNet) and DTG Community Telephone, Inc. All significant intercompany transactions and accounts have been eliminated.

C. Basis of Accounting - The accounting policies of the Company are in conformity with generally accepted accounting principles and the Company does not have any regulatory assets or liabilities as defined by Financial Accounting Standards Board Statement No. 71, "Accounting for the Effects of Certain Types of Regulation".

D. Deferred Charges - Deferred Charges include the cost of computer software that is being developed for internal use. These costs will be amortized over three years when the software is completed and placed into service.

E. Accounting Estimates - The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

F. Cash Investments - Cash and cash equivalents include general funds and short-term investments with original maturities of three months or less. Investments with original maturities of three months to twelve months are classified as temporary cash investments. Cash investments are valued at market value.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

G. Materials and Supplies - Materials and supplies are recorded at average unit cost and inventory held for resale is valued at the lower of first-in, first-out cost or market. Balances as of December 31, 1997, and 1996 are :

| | 1997 | 1996 |
|---|---|---|
| Materials and Supplies | $ 797,521 | $ 528,546 |
| Inventory | 311,705 | 165,551 |
| Total | $ 1,109,226 | $ 694,097 |

H. Property, Plant and Depreciation - Property, plant and equipment are recorded at original cost. Additions, improvements or major renewals are capitalized. If the telecommunication and cable television utility plant is sold, retired or otherwise disposed of in the ordinary course of business, the cost plus removal costs less salvage, is charged to accumulated depreciation.

Depreciation is computed using principally the straight-line method based upon the estimated service lives of the depreciable assets.

I. Excess of Cost Over Net Assets Acquired - The excess of cost over net assets of acquired companies is being expensed equally over fifteen years and is shown net of accumulated amortization of $150,030 and $10,032 at December 31, 1997, and 1996.

J. Other Intangible Assets - Other intangible assets consist of customer lists ($628,026 and $541,300 as of December 31, 1997, and 1996) and is being expensed equally over fifteen years and shown net of accumulated amortization of $73,193 and $31,741 at December 31, 1997, and 1996. Other intangible assets also include the cost ($255,010) of a Broadband Personal Communications Service System license at December 31, 1997.

K. Other Investments - Other investments are recorded at cost.

L. Capital Credits - The Company operated as a cooperative until July 21, 1997. Amounts received from the furnishing of telephone service, interest income and other nonoperating operations in excess of costs and expenses were assigned to telephone patrons on a patronage basis to the extent they were not needed to offset prior losses.

M. Revenue Recognition - Revenues are recognized when earned, regardless of the period in which they are billed. Network access and long distance revenues are furnished in conjunction with interexchange carriers and are determined by cost separation studies. Revenues include estimates pending finalization of cost studies. Network access revenues are based upon interstate tariffs filed with the Federal Communications Commission by the National Exchange Carriers Association and state tariffs filed with state regulatory agencies. Management believes recorded revenues are reasonable based on estimates of final cost separation studies which are typically settled within two years.

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

N. Income Taxes - Until July 21, 1997, the Parent Company operated as a cooperative and had been granted tax exempt status under Section 501(c)12 of the Internal Revenue Code; therefore the Parent Company income was not taxable. The State of South Dakota does not have an income tax.

After July 21, 1997, the Parent Company became subject to federal income taxes and files a consolidated return with its wholly owned subsidiaries, which are subject to federal income taxes and Minnesota and Iowa income taxes for operations in those states. Income taxes for these companies are provided for the tax effects of transactions reported in the financial statements and include taxes currently payable and deferred income taxes which reflect the estimated income tax consequences of the differences between the income tax bases of assets and liabilities and their financial reporting bases. Temporary differences are primarily depreciation and net operating losses carryforwards.

O. Credit Risk - Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments. The Company places its temporary cash investments with high credit quality financial institutions and, by policy, generally limits the amount of credit exposure to any one financial institution. Concentrations of credit risk with respect to trade receivables are limited due to the Company's large number of customers. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk.

P. Allowance for Funds Used During Construction - The Company includes in its telecommunication and cablevision plant accounts an average cost of debt used for the construction of the plant, and excludes the amounts from interest expense on the statement of operations. The amount capitalized for 1997 was $171,800.

Q. Reclassifications - Certain reclassifications have been made to the 1996 financial statements to conform to the 1997 presentation. These reclassifications had no effect on net income.

## NOTE 2 - REORGANIZATION

At a special meeting of the stockholders on July 21, 1997, an amendment to the Company's articles of incorporation was approved which resulted in the conversion of the Company from a cooperative to a South Dakota business corporation. Also at a meeting convened on July 21, 1997, and subsequently adjourned and completed on July 25, 1997, the shareholders of the South Dakota business corporation approved an Agreement and Plan of Merger that provided for the subsequent merger of the South Dakota business corporation with and into the Company. The conversion of equity in the Cooperative to equity in the South Dakota business corporation and then into equity in the Company was at the rate of one share of common stock for each share of the Cooperative's common stock, 80.8216445 shares of common stock for each share of preferred stock and 0.2 of a share of common stock for each dollar of capital credits.

## NOTE 2 - REORGANIZATION (Continued)

General and administrative expenses for the year ended December 31, 1997, includes $611,342 of costs relating to the reorganization of the Company.

## NOTE 3 - PROPERTY, PLANT AND EQUIPMENT

The cost and estimated useful lives of property, plant and equipment are as follows:

| | Estimated Useful Life | | 1997 | 1996 |
|---|---|---|---|---|
| Land | | | $ 101,573 | $ 101,573 |
| Buildings | 20-33 | years | 2,669,620 | 1,486,491 |
| Leasehold Improvements | 5 | | 242,886 | 15,677 |
| Machinery and Equipment | 5-10 | | 2,250,495 | 1,499,518 |
| Furniture and Fixtures | 3-20 | | 2,076,192 | 1,010,234 |
| Telecommunications Plant | 4-20 | | 23,947,827 | 16,922,589 |
| Cable Television Plant | 8-12 | | 5,352,431 | 4,869,851 |
| Construction In Progress | - | | 288,504 | 354,025 |
| | | | 36,929,528 | 26,259,958 |
| Less Accumulated Depreciation | | | 11,521,262 | 11,818,854 |
| Total | | | $ 25,408,266 | $ 14,441,104 |

Depreciation included in costs and expenses was $3,265,650 in 1997 and $2,392,643 in 1996.

The Company intends to add new construction in 1998 of approximately $37,000,000 which is expected to be financed through additional long-term financing.

## NOTE 4 - NOTE PAYABLE

The Company has a line of credit arrangement for $1.5 million with RTFC which expires in 2002. Interest is payable quarterly at variable monthly rates determined by RTFC with a cap at prime plus 1.5%. Any advances must be paid in full within 360 days of the advance and remain at a zero balance for at least five consecutive business days. Advances from the line of credit were used to finance construction approved in the RTFC long-term agreements. The $1.5 million outstanding note balance was paid in full January 1998.

## NOTE 4 - NOTE PAYABLE (Continued)

The Company has a line of credit arrangement for $800,000, at the prime rate, with Norwest Bank, South Dakota, N. A. which expires January 31, 1998. This arrangement was obtained through acquisition of a new subsidiary in 1997. No amounts were outstanding as of December 31, 1997.

## NOTE 5 - PAYABLE UNDER FLOOR PLAN ARRANGEMENT

The Company has floor plan agreements with Deutsche Financial Services and IBM Credit Corporation under which it may borrow up to 100% of the cost of qualified purchases. The agreement with Deutsche Financial Services has a $1,400,000 credit limit with no interest for up to 30 days and 15% interest after 30 days. The agreement with IBM Credit Corporation has a $350,000 credit limit with no interest for up to 30 days, 8.85% for 30-45 days and 9.2% after 45 days. The amount borrowed under these agreements must be repaid when the financed items are sold or disposed of in any manner. The agreements are secured by all the assets of the Company's subsidiary, DTG DataNet, Inc. and include various covenants which have been approved by RTFC.

## NOTE 6 - LONG-TERM DEBT

Long-term debt is as follows:

| | 1997 | 1996 |
|---|---|---|
| Rural Telephone Finance Cooperative (RTFC) Mortgage Note, matures 2012, variable interest rate (6.65% at December 31, 1997) | $ 28,184,830 | $ - |
| Rural Telephone Finance Cooperative (RTFC) Mortgage Note, matures 2006, variable interest rate (6.65% at December 31, 1997) | 1,405,639 | 1,537,537 |
| Home Federal Savings Bank, matures 2007, variable interest rate (9.5% at December 31, 1997) (ESOP loan guaranteed by the Company) | 1,000,000 | - |
| Rural Utilities Service (RUS) mortgage notes: | | |
| 2% payable in quarterly installments | - | 2,595,175 |
| 5% payable in monthly installments | - | 10,756,343 |
| Norwest Bank South Dakota, N.A., variable interest rate (prime plus one percent) | - | 980,469 |
| Other | - | 166,571 |
| | 30,590,469 | 16,036,095 |
| Amount Due Within One Year | (1,390,000) | (697,700) |
| Total Long-Term Debt | $ 29,200,469 | $ 15,338,395 |

## NOTE 6 - LONG-TERM DEBT (Continued)

The Company received loans of $14,737,000 and $13,684,000 from RTFC for the purposes of refinancing its RUS debt and RTFC lines of credit and to finance plant construction. The loans are payable quarterly, with full payment due in fifteen years. On July 15, 1997, the Company retired its entire RUS debt with loan proceeds from RTFC. In order to obtain financing from RTFC, the loans include borrowings of $1,449,185 to purchase Subordinated Capital Certificates (SCC) of RTFC. The SCCs bear no interest and will be repaid to the Company. SCCs are included in other investments on the balance sheet. The Company is required to maintain a debt service coverage of not less than 1.25 and a times interest earned ratio of not less than 1.50. Each ratio is determined by averaging the two highest annual calculations during the three most recent fiscal years. The Company is restricted from incurring any additional unsecured debt in excess of five percent of total assets from any other lender and from declaring or paying any dividend or purchasing or redeeming any capital stock in excess of 25 percent of the prior fiscal year-end cash margins without written approval of the lender.

Unadvanced loan funds of $94,181 are available to the Company on loan commitments from RTFC. Loan proceeds will be used to finance future construction. The RTFC loans, maturing in 2012, are collateralized by all assets, revenues and stock of the Company's subsidiaries. The RTFC loan, maturing in 2006, is collateralized by the cable plant located in ten cities in southeastern South Dakota and is payable in quarterly installments.

The loan from Home Federal Savings Bank is guaranteed by the Company and is payable by the Company's ESOP in ten equal installments beginning in 1998.

Approximate annual principal payments on the existing debt for the next five years are: 1998 - $1,390,000; 1999 - $1,491,000; 2000 - $1,595,000; 2001 - $1,706,000 and 2002 - $1,825,000.

## NOTE 7 - CAPITAL STOCK

| | Preferred | | Common | | Treasury | | Unearned ESOP Plan | |
|---|---|---|---|---|---|---|---|---|
| | Issued Shares | Amount | Issued Shares | Amount | Issued Shares | Amount | Shares | Amount |
| BALANCE - December 31, 1995 | | $ | 5,225 | $ 26,125 | | $ | | $ |
| Issued | 1,172 | 1,172,000 | 456 | 2,280 | | | | |
| Redeemed | | | (444) | (2,220) | | | | |
| BALANCE - December 31, 1996 | 1,172 | 1,172,000 | 5,237 | 26,185 | | | | |
| Issuance of Common Stock in Exchange for Capital Credits and Capital Stock | | | 459,954 | 2,299,770 | | | | |
| Issuance of Common Stock in Exchange for Preferred Stock | (1,172) | (1,172,000) | 94,727 | 1,172,000 | | | | |
| Issuance of Common Stock to Purchase Futuristic, Inc. (d/b/a DataNet) | | | 160,000 | 4,000,000 | | | | |
| Issuance of Common Stock to ESOP | | | 49,213 | 1,000,000 | | | (49,213) | (1,000,000) |
| Issuance of Common Stock to Employees | | | 2,043 | 25,915 | | | | |
| Repurchase of Common Stock | | | | | 493 | (12,325) | | |
| Two-for-One Stock Split | | | 771,174 | | 493 | | (49,213) | |
| BALANCE - December 31, 1997 | - | $ - | 1,542,348 | $ 8,523,870 | 986 | $ (12,325) | (98,426) | $ (1,000,000) |

On December 16, 1997, the Board of Directors declared a two-for-one common stock split pursuant to a share dividend paid to common stockholders of record on January 1, 1998. All common stock share amounts shown below have been adjusted for the stock split.

As of December 31, 1996, the Company's common stock had a par value of $5 per share. There were 15,000 shares authorized. No person could own more than one share of common stock and each holder of common stock had one vote in the affairs of the Company.

Nonvoting preferred stock had a par value of $100 per share and there were 63,000 shares authorized. The preferred stock is shown on the balance sheet at its redemption value of $1,000 per share. Preferred shareholders were entitled to a Non-Liquidity Fee of $80 per share payable semi-annually in cash or preferred stock at the discretion of the Company. Preferred shareholders also were granted warrants which entitle them to purchase additional preferred stock at $1,000 per share.

## NOTE 7 - CAPITAL STOCK (Continued)

At December 31, 1996, and 1997, there were warrants outstanding which may be exercised through January 21, 1998 to purchase 482 shares of preferred stock which were converted to 77,912 shares of common stock. These warrants were exercised on January 21, 1998. Effective January 1, 1997, the Company granted management options to purchase up to 1,534 shares of preferred stock at $1,000 a share which were replaced with common stock under the Executive Stock Option Plan.

As of December 31, 1997, the Company has 5,000,000 shares of no par common stock authorized and 1,542,348 shares are issued and outstanding. The Company also has 250,000 shares of no par preferred stock of which 15,000 shares are designated as Series A Junior Participating preferred stock. No preferred stock is outstanding as of December 31, 1997.

Former holders of Cooperative common stock and capital credit accounts are entitled to receive shares of common stock of the Company, without any further consideration, upon receipt by the Company of properly executed transmittal documents in acceptable form. If all such persons had satisfied the conditions to receive shares at December 31, 1997, a total of 911,320 additional shares of the Company's common stock would have been issued and outstanding at that date. Other capital includes that amount of stockholders equity which would have been included in common stock if those shares had been issued and outstanding at December 31, 1997.

On July 22, 1997, the Board of Directors adopted a leveraged employee stock ownership plan ("ESOP"). The ESOP purchased 98,426 shares of common stock for $1,000,000 in December 1997. The purchase price per share is approximately the same as fair value per share at December 31, 1997, based upon an appraisal. Under the terms of the Plan, employees who are not part of a collective bargaining unit, a leased employee or a nonresident alien and have completed at least 1,000 hours of service become eligible to participate in the plan. The Company determines the amount of contributions that will be made each year. The contribution is allocated among eligible participants based on compensation in proportion to total compensation paid to all eligible participants. Any dividends earned will be allocated to the participant's account based on allocated shares. A participant becomes fully vested after five years of service or upon normal retirement date. No contributions were made to the ESOP in 1997.

On July 22, 1997, the Board of Directors declared a dividend of one right for each outstanding share of common stock to common stockholders of record on August 5, 1997. Each right allows the holder to purchase one one-hundredth of a share of Series A Junior Participating Preferred Stock. The exercise price of the rights are $100 per right and the redemption price is $.01. The rights expire August 4, 2007.

In July 1997, the Company adopted the 1997 Stock Incentive Plan that provides for stock options, stock appreciation rights, restricted stock, stock awards and tax benefit rights for key employees and provides for automatic awards of stock options to nonemployee directors of the Company which expire ten years after being granted. The Company has reserved 350,000 shares of common stock for this plan.

In November 1997, the Company adopted the Director Stock Plan of 1997 that provides that stock may be awarded to outside directors upon their fifth anniversary of service as an outside director. The Company has reserved 40,000 shares of common stock for this plan.

## NOTE 7 - CAPITAL STOCK (Continued)

In November 1997, the Company adopted the Executive Stock Option Plan of 1997 that provides that options for 247,960 shares of common stock may be awarded to officers and other key employees of the Company which expire ten years after being granted. Options for 247,960 shares of common stock were granted under this plan to replace preferred stock options for 1,534 shares at $1,000 per share.

At December 31, 1997, there were options for 285,640 shares outstanding which were granted during 1997. Exercise prices of outstanding stock options are 267,640 shares at $6.19 and 18,000 shares at $12.50 per share. The average exercise price is $6.59 per share The average remaining life of outstanding stock options at December 31, 1997, was 6.12 years. Options exercisable at December 31, 1997, are 53,528 shares at $6.19 and 6,480 shares at $12.50 per share.

The Company has adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", but applies APB Opinion No. 25, "Accounting for Stock Issued to Employees" for measurement and recognition of stock-based transactions with its employees. If the Company had elected to recognize compensation cost for its stock based transactions using the method prescribed by SFAS No. 123, net loss and loss per share since reorganization would have been $(1,782,202) and $(1.47).

The fair value of the Company's stock options used to compute pro forma net loss and net loss per share disclosures is the estimated present value at grant date using the Black-Scholes option-pricing model with the following assumptions: expected volatility of 30%, a risk free interest rate of 5.70% to 6.33%, an expected holding period of seven years and no dividend yield. Pro forma stock-based compensation cost was $150,000 in 1997.

The Company approved an offering of 400,000 shares of common stock at a purchase price of $12.50 per share to shareholders and employees as of January 27, 1998. The offering expires on March 11, 1998.

## NOTE 8 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of cash and temporary cash investments approximates their fair value due to the short maturity of the instruments. The fair value of the Company's long-term debt at December 31, 1997, is estimated to be approximately equal to the carrying value of $29,200,469. The fair value of the Company's long-term debt at December 31, 1996, after deducting current maturities, is estimated to be $12,905,145, compared to carrying values of $15,338,395. The fair value estimates are based on the overall weighted rates and maturity compared to rates and terms currently available in the long-term financing markets.

## NOTE 9 - DEPOSITS

On December 7, 1994, the Company and its wholly owned subsidiary, Dakota Telecommunications Systems, Inc., entered into an agreement with U S West Communications, Inc. to purchase the assets and acquire the right to provide and operate wireline telecommunication services in eight exchanges in the state of South Dakota for $10,144,884. In 1996, the Company canceled the agreement. The Company had a $549,778 earnest money deposit on the purchase. The deposit was written down by $274,889 to the estimated recoverable amount of $274,889, which was received in 1997. In addition, the Company expensed $275,252 of related acquisition costs in 1996.

## NOTE 10 - SUPPLEMENTAL CASH FLOW INFORMATION

| | 1997 | 1996 |
|---|---|---|
| CASH PAYMENTS (REFUNDS), NET FOR: | | |
| Interest | $ 1,287,837 | $ 730,633 |
| Income Taxes | $ (215,056) | $ 283,415 |
| NONCASH INVESTING AND FINANCING ACTIVITY: | | |
| Acquisitions | | |
| Fair Value of Assets | $ 4,796,848 | $ 2,607,631 |
| Liabilities | 721,036 | 1,389,208 |
| Net Assets Acquired | 4,075,812 | 1,218,423 |
| Less: Common Stock Issued for Acquisitions | 4,000,000 | 1,172,000 |
| Cash Acquired | - | 6,128 |
| Acquisition Costs, Net of Cash Acquired | $ 75,812 | $ 40,295 |

## NOTE 11 - INCOME TAXES

Income tax expense (benefit) consists of the following:

| | 1997 | 1996 |
|---|---|---|
| Current | $ (29,543) | $ (225,740) |
| Deferred | (88,932) | 50,028 |
| Total | $ (118,475) | $ (175,712) |

Federal and state income tax operating loss carryovers as of December 31, 1997, were $2,749,000 and will expire in 2012.

## NOTE 11 - INCOME TAXES (Continued)

Deferred tax assets and (liabilities) as of December 31, 1997, and 1996 relate to the following:

| | 1997 | 1996 |
|---|---|---|
| Accelerated Depreciation | $ (251,684) | $ (88,932) |
| Loss Carryforward | 875,057 | |
| Other | 165,610 | |
| Valuation Allowance | (788,983) | |
| Total | $ - | $ (88,932) |

At December 31, 1997, the Company had net deferred tax assets primarily as a result of the net operating losses. The full amount of the net deferred tax asset was offset by a valuation allowance due to uncertainties relating to the full future utilization of these net operating losses.

The differences between the statutory federal rate and the effective tax rate were as follows:

| | 1997 | 1996 |
|---|---|---|
| Consolidated (Loss) Before Income Taxes | $ (2,605,262) | $ (335,946) |
| Less Tax Exempt (Income) Loss | 570,910 | (100,729) |
| Taxable Loss | $ (2,034,352) | $ (436,675) |
| Statutory Tax Rate | 35.0% | 35.0% |
| Valuation Allowance | (34.4) | - |
| Effect of Graduated Rates and Other | 5.2 | 5.2 |
| Effective Tax Rate | 5.8% | 40.2% |

## NOTE 12 - PENSION PLANS

Pension benefits for substantially all employees are provided through the National Telephone Cooperative Association Retirement and Security Program (a defined benefit plan) and Savings Plan (a defined contribution plan). The Company makes annual contributions to the plans equal to the amounts accrued for pension expense. The Retirement and Security Program is a multi-employer plan and the accumulated benefits and plan assets are not determined or allocated separately by individual employer. The total pension costs for 1997 and 1996 were $218,673 and $150,220.

## NOTE 13 - ACQUISITIONS

In December 1997, the Company acquired Futuristic, Inc., a South Dakota Corporation doing business as DataNet, Inc. ("DataNet"), in exchange for 320,000 (after the two-for-one split) shares of common stock valued at $4,000,000. The acquisition was accounted for as a purchase. The excess of the aggregate purchase price and liabilities assumed exceed the fair value of the assets by $3,178,136 and is being expensed equally over fifteen years. Operations of the Company acquired are included in the consolidated statement of operations subsequent to its purchase.

In the first half of 1996, Dakota Telecom, Inc. purchased the assets of nineteen cable service areas from three companies that provided cable services to various communities in addition to the assets purchased by Dakota Telecom, Inc. in three separate purchase transactions and one asset exchange transaction. The total purchase price was $3,858,704. Customer lists acquired for $541,300 are being expensed equally over 15 years. Operations of the service areas purchased are included in the consolidated statements of operations subsequent to their purchase.

In December 1996, the Company acquired I-Way Partners, Inc. and TCIC Communications, Inc. in exchange for 1,172 shares of preferred stock valued at $1,172,000. The acquisitions were accounted for as purchases. The excess of the aggregate purchase price and liabilities assumed exceed the fair value of the assets by $1,840,991 and is being expensed equally over fifteen years. Operations of the companies acquired are included in the consolidated statement of operations subsequent to their purchase.

The following unaudited consolidated pro forma information assumes the acquisitions had occurred at the beginning of each of the following years:

| | 1997 | 1996 |
|---|---|---|
| Total Revenues | $ 27,251,152 | $ 24,729,339 |
| Net Loss For the Year | (2,383,332) | (493,496) |
| Net Loss Per Share (Since Reorganization) | (1.30) | |

The Company has entered into a merger agreement to purchase the outstanding stock of Vantek Communications, Inc. and Van/Alert, Inc. in exchange for stock, cash and notes valued at $1,100,000. The purchase is pending FCC approval.

## NOTE 14 - CHANGE IN ACCOUNTING ESTIMATE

Effective January 1, 1996, the Company revised its estimate of the useful lives of telecommunication computers and fiber optic cable which were being depreciated over 12 and 25 years. The revised useful lives are 4 and 10 years.

## NOTE 14 - CHANGE IN ACCOUNTING ESTIMATE (Continued)

Effective February 1, 1996, the Company revised its estimate of the useful lives of cable television plant. Previously the plant was depreciated over 20 years. The revised useful life of the plant ranges from eight to twenty years. These changes were made to better reflect the estimated periods during which such assets will remain in service. The 1996 changes increased depreciation expense by approximately $189,000 in 1996.

## NOTE 15 - LOSS PER SHARE

Basic loss per share was computed by dividing the net loss of $(1,632,202) for only the period since the reorganization (July 21, 1997 to December 31, 1997) by the weighted average number of common shares outstanding (1,213,442 shares) during the period since the reorganization adjusted for the two-for-one stock split. Shares issued as a result of the reorganization were considered outstanding for the entire period. Net loss of $(854,585) for the period prior to the reorganization was not considered in the loss per share calculation.

Options, rights and warrants have not been considered in the computation of diluted loss per share since their effect would be anti-dilutive because of the net loss. If the 911,320 shares issuable at December 31, 1997 to former holders of Cooperative common stock and capital credit accounts upon satisfaction by such holders of conditions to issuance, which have not been issued as a result of the reorganization, were considered issued for the entire period, the loss per share would have been $(.77).

## NOTE 16 - SEGMENT INFORMATION

The Company operates in three businesses: telecommunications, cable television and computer network sales. Industry segment information is as follows:

| | 1997 | 1996 |
|---|---|---|
| Revenues: | | |
| Telecommunications | $ 10,048,303 | $ 6,752,185 |
| Cable Television | 1,892,585 | 1,349,157 |
| Computer Network Sales | 1,788,104 | - |
| | $ 13,728,992 | $ 8,101,342 |
| Operating Income (Loss): | | |
| Telecommunications | $ (1,383,297) | $ 454,097 |
| Cable Television | (430,730) | (376,247) |
| Computer Network Sales | 55,368 | - |
| | $ (1,758,659) | $ 77,850 |
| Identifiable Assets: | | |
| Telecommunications | $ 29,075,590 | $ 18,246,345 |
| Cable Television | 9,217,881 | 5,258,530 |
| Computer Network Sales | 5,746,421 | - |
| | $ 44,039,892 | $ 23,504,875 |

## NOTE 16 - SEGMENT INFORMATION (Continued)

| | 1997 | 1996 |
|---|---|---|
| Depreciation and Amortization Expense: | | |
| Telecommunications | $ 2,727,991 | $ 2,011,046 |
| Cable Television | 702,778 | 423,370 |
| Computer Network Sales | 17,340 | - |
| | $ 3,448,109 | $ 2,434,416 |
| Capital Expenditures: | | |
| Telecommunications | $ 10,204,443 | $ 1,930,389 |
| Cable Television | 2,887,753 | 3,821,215 |
| Computer Network Sales | 471,828 | - |
| | $ 13,564,024 | $ 5,751,604 |

## STOCK INFORMATION

### Absence of Trading Market

No public trading market currently exists for shares of the Company's common stock, no par value ("Common Stock"). However, the Company intends to ask one or more regional brokerage firms to act as a market maker for shares of the Company's Common Stock. In addition, the Company intends to apply to have shares of its Common Stock quoted for trading on The Nasdaq Stock Market. There can be no assurance that the Company will be successful in finding a brokerage firm to act as a market maker for its Common Stock or that shares of the Company's Common Stock will ever be quoted for trading on The Nasdaq Stock Market. Similarly, there can be no assurance that a trading market will develop or be maintained for shares of the Company's Common Stock.

### Record Holders of Common Stock

As of March 16, 1998, there were approximately 4,299 holders of record of shares of the Company's Common Stock, representing 1,907,255 shares. An additional 3,818 holders of common stock and capital credit accounts issued by the cooperative are eligible to receive an aggregate of 593,262 additional shares of Common Stock upon satisfaction by those holders of the exchange and informational conditions under the Company's cooperative conversion plan.

### Cash Dividends

Since its formation in 1997, the Company has not paid cash dividends on Common Stock. Holders of Common Stock are entitled to dividends out of funds legally available for that purpose if, as and when declared by the Board of Directors of the Company. Certain covenants in existing loan agreements between the Company and the RTFC limit the circumstances under which Company would be permitted to pay dividends or make other distributions to Company stockholders. The loan terms provide that the Company must on a consolidated basis maintain a minimum annual debt coverage service ratio (total net income or margins plus depreciation and interest on long-term debt for a year divided by principal and interest on long-term debt payable in that year) and a minimum average ratio of net income to total interest expense on long-term debt. In addition, the loan subjects the Company to certain minimum net worth requirements, and in some cases requires the Company to obtain prior written consent from the RTFC in order to pay any dividends or distributions to stockholders. Under these agreements, the RTFC must authorize distributions other than in shares of stock unless these financial ratio requirements are met. The dividend rights of the Company's Common Stock also are subject to the rights of any Company preferred stock which has been or may be issued.

## BOARD OF DIRECTORS AND SENIOR MANAGEMENT

### Board of Directors

*Craig A. Anderson*
Executive Vice President, Chief Financial Officer and Treasurer of the Company

*Ross L. Benson*
Agribusiness (farm) owner and operator

*Dale Q. Bye*
Semi-retired agribusiness (farm) owner and operator

*Jeffrey J. Goeman*
President and Owner of Goeman Auction Service and Real Estate, Inc. (real estate brokerage and appraisal and auction firm)

*Thomas W. Hertz*
Chief Executive Officer and President of the Company

*James H. Jibben*
Chairman of the Board of Directors of the Company and an agribusiness (farm) owner and operator

*Palmer O. Larson*
Semi-retired agribusiness (farm) owner and operator

*Jeffrey G. Parker*
President and Chief Executive Officer of Parker Transfer and Storage, Inc. (transportation and storage company) and President of Slip and Trip, Inc. (service provider to Parker Transfer and Storage, Inc.)

*John (Jack) A. Roth*
Retired agent for State Farm Insurance (insurance company)

*John A. Schaefer*
Retired agribusiness (farm) owner and operator

### Director Emeritus

*Edward D. Christensen, Jr.*
Semi-retired agribusiness (farm) owner and operator

### Corporate Executive Officers

*Thomas W. Hertz*
Chief Executive Officer and President

*Craig A. Anderson*
Executive Vice President, Chief Financial Officer and Treasurer

*Timothy Dupic*
Secretary and Vice President of Operations

Dakota Telecommunications Group